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## The Little Train That Couldn't: Did the Pennsylvania Anti-Takeover Statute Fail to Protect Conrail from a Hostile Suitor?

### Cover Page Footnote

I would like to dedicate this Note to Bertha Elkin and Beulah Hecht, my two wonderful grandmothers, who have been a constant source of support and inspiration.

## NOTES

### THE LITTLE TRAIN THAT COULDN'T: DID THE PENNSYLVANIA ANTI-TAKEOVER STATUTE FAIL TO PROTECT CONRAIL FROM A HOSTILE SUITOR?

David N. Hecht\*

"We are delighted to be merging with our ideal partner."<sup>1</sup>

October 15, 1996, Conrail Chairman David LeVan, referring to the proposed *friendly merger* with CSX.

"[W]e have succeeded in negotiating the best possible transaction for all of Conrail's constituencies."<sup>2</sup>

March 7, 1997, Conrail Chairman David LeVan, referring to the *split up* of Conrail between friendly bidder CSX and hostile bidder Norfolk Southern.

#### INTRODUCTION

Until 1997, Conrail Inc.<sup>3</sup> ("Conrail"), the Philadelphia-based parent of Consolidated Rail Corporation, was the fifth largest railroad in the United States.<sup>4</sup> It operated the largest freight railroad in the Northeast quarter of the United States,<sup>5</sup> controlled over 11,000 miles of track, employed over 23,000 people, and generated annual revenues in excess of \$3 billion.<sup>6</sup> CSX Corporation ("CSX"), headquartered in Florida, was the third largest railroad in the United States.<sup>7</sup> It operated rail services over 32,000 miles of track throughout the United

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1. *CSX and Conrail to Combine in Pro-Competitive, Strategic Merger*, PR NEWswire, Oct. 15, 1996, available in WESTLAW, PRNEWS Database.

2. *Conrail Shareholders to Receive \$115 in Cash Per Share Under Amended CSX-Conrail Merger Agreement*, PR NEWswire, Mar. 7, 1997, available in WESTLAW, PRNEWS Database.

3. Conrail was formed by the United States government in 1976 through the amalgamation of six bankrupt northeastern railroads. Shirley A. Lazo, *Speaking of Dividends*, Barron's, July 26, 1993, at 42. In 1986, the government responded to a hostile acquisition attempt by offering the stock to the public for \$1.2 billion. Suzanne Wooton, *Railroads Nearing Accord on Takeover: CSX Would Purchase Conrail, Sell Lines To Norfolk Southern*, Baltimore Sun, Mar. 4, 1997, at 1A.

4. Vincent F. Garrity, Jr. & Mark A. Morton, *Would the CSX/Conrail Express Have Derailed in Delaware? A Comparative Analysis of Lock-up Provisions Under Delaware and Pennsylvania Law*, 51 U. Miami L. Rev. 677, 677-78 (1997).

5. *Conrail Corporate Profile* (visited April 14, 1997) <<http://www.conrail.com/FMBCPROF.html>>. Conrail services Connecticut, Delaware, Illinois, Indiana, Maryland, Massachusetts, Michigan, New Jersey, New York, Ohio, Pennsylvania, West Virginia, the District of Columbia, and the Province of Quebec. *Id.*

6. *Id.* In addition, Conrail owned or leased approximately 2000 locomotives and 53,000 freight cars. *Id.*

7. See Garrity & Morton, *supra* note 4, at 677.

States and Canada,<sup>8</sup> and generated annual revenues in excess of \$10.5 billion.<sup>9</sup> Norfolk Southern Corporation ("Norfolk"), headquartered in Virginia, controlled over 25,000 miles of track throughout the United States and Canada,<sup>10</sup> employed over 23,000 people, and generated annual revenues in excess of \$4 billion.<sup>11</sup>

When CSX and Conrail announced in October 1996 that they intended to merge, the stakes were high.<sup>12</sup> Conrail was long considered a potential takeover target by Norfolk.<sup>13</sup> The saga originated when David LeVan, CEO of Conrail, sought out CSX in October 1996 to act as a preemptive "white knight."<sup>14</sup> LeVan stated that "recent changes in industry structure and in U.S. patterns of distribution require[d] a broader market reach."<sup>15</sup> He met with John Snow, CEO of CSX, and suggested a friendly merger, while at the same time refusing to accommodate Norfolk.<sup>16</sup>

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8. *CSX Transportation Inc. Corporate Profile* (visited April 14, 1997) <<http://www.csxt.com/index.html>>.

9. Charles Slack, *Service Companies Had A Buying Spree; Acquisitions Near and Far Boosted Local Businesses*, Richmond Times-Dispatch, Apr. 13, 1997, at E9.

10. *Norfolk Southern Corporate Profile* (visited April 14, 1997) <<http://www.nscorp.com/nscorp/html/profile.html>>.

11. *Id.* Norfolk also owned or leased over 2000 locomotives and 91,000 freight cars. *Id.*

12. Associated Press, *Conrail Holders Give CSX Loss in Takeover Fight With Norfolk*, Investor's Bus. Daily, Jan. 20, 1997, at A8. Many observers concluded that neither Norfolk nor CSX could afford to lose the battle for control of Conrail. See *Sharing the Wealth to End a Fight*, Mergers & Acquisitions, May 15, 1997, at 5.

13. Steve Lipin, et. al., *Norfolk Southern Bids \$9.1 Billion for Conrail*, Wall St. J., Oct. 24, 1996, at A3. As early as 1985, "the Reagan administration proposed that the federal government sell Conrail to Norfolk Southern." Charles Slack, *On A Collision Course: CSX Picks Up Steam in Fight For Conrail*, Richmond Times-Dispatch, Dec. 2, 1996, at D14. In 1994, Norfolk offered 1.1 Norfolk shares for each share of Conrail. *Id.* This was rejected and in October 1995 LeVan and Goode met to discuss the possibility of a Norfolk acquisition. *Id.* LeVan rejected the advances and began to fear a potential hostile takeover situation. *Id.*

14. A "white knight" is the current Wall Street metaphor for an entity that is sought out by a target company confronting a hostile bid, see *infra* note 19, to acquire the company in place of the hostile bidder. William A. Klein & John C. Coffee, Jr., *Business Organization and Finance* 181 (6th ed. 1996). Although the target would prefer to avoid any acquisition, the white knight is a more appealing acquirer, often working in cooperation with current management. *Id.*

15. PR NEWswire, Oct. 15, 1996, *supra* note 1.

16. Daniel Machalaba & Anna W. Mathews, *Railroading: For Conrail's Chief, A Deal With CSX Marks Bitter Setback*, Wall St. J. Eur., Mar. 5, 1997, at 1. Although Norfolk had discussed a possible merger with Conrail in the past, David Goode, Norfolk's President and Chief Executive Officer, only seemed willing to offer LeVan "an appropriate position" as opposed to CEO or President. *Id.* Observers felt this ambiguous gesture created bad blood between the two. *Id.* Originally, in the planned merger between Conrail and CSX, Snow was to retire within two years, allowing LeVan, the would-be chief operating officer, to succeed into Snow's post. Joseph Weber & Christina Del Valle, *What Might Derail the CSX-Conrail Merger*, Bus. Wk., Oct. 28, 1996, at 50.

As the deal unfolded, LeVan lost control of the merger process.<sup>17</sup> Despite resorting to Pennsylvania's anti-takeover laws,<sup>18</sup> he was unable to keep Norfolk out of the picture. Norfolk responded immediately to the proposed CSX-Conrail union by making a hostile bid for Conrail.<sup>19</sup> The victor was expected to create the third largest railroad in the United States,<sup>20</sup> while the loser would be locked out of the East Coast, where Conrail's operations are concentrated.<sup>21</sup> Ironically, only six months later, hostile bidder Norfolk and friendly bidder CSX came to an agreement to effectively split up Conrail.<sup>22</sup> Shareholders saw their holdings increase in value by 65%<sup>23</sup> as a result of Conrail management's inability to prevent its breakup by a hostile bidder.<sup>24</sup> The proposed transaction, splitting up Conrail between Norfolk and CSX, is currently awaiting approval from the Surface Transportation Board (the "STB").<sup>25</sup> It is likely that approval will be granted because the STB helped negotiate the arrangement between the three railroad companies.<sup>26</sup>

Despite the complexity of the merger agreement and bidding war that followed, at the heart of the contest were two provisions of a Pennsylvania law intended to thwart hostile takeovers.<sup>27</sup> Although the Pennsylvania legislation, taken as a whole, has a single purpose, an analysis of these provisions reveals that they often have conflicting implications and represent inconsistent policies. In the context of the Conrail merger, the ineffectiveness of the provisions resulted in a hostile bidder ultimately acquiring partial control over a local company.

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17. Machalaba & Mathews, *supra* note 16, at 1. LeVan had no intention of ultimately ceding control of Conrail to Norfolk's Goode. *Id.*

18. Discussed *infra* Part II.

19. *Conrail Advises Shareholders to Await Board Response to Norfolk Southern Unsolicited Offer Before Taking Any Action*, PR NEWswire, Oct. 23, 1996, available in WESTLAW, PRNEWS Database. A hostile bid is an offer opposed by incumbent management, generally made by a suitor, often characterized in the 1980s as a "corporate raider," who seeks to acquire control of the company and oust incumbent management. Neil Fabricant, *Hostile Tender Offers: Can The States Shut Them Down?*, 22 J. Corp. L. 27, 29 (1996).

20. *Conrail Holders Give CSX Loss in Takeover Fight With Norfolk*, *supra* note 12, at A8.

21. *Id.*

22. Christopher Dinsmore, *How Norfolk Southern Derailed the Merger of CSX and Conrail*, *Virginian-Pilot & Ledger Star*, March 5, 1997, at D1.

23. Andrew Cassel, *Antitakeover Law Enriched Conrail Shareholders*, *Phila. Inquirer*, Mar. 19, 1997, at C1. The final bid for Conrail was \$115 per share, *id.*, whereas, in September 1996 the stock price fluctuated around \$70 per share. See Standard & Poor's Stock Reports, Conrail, Jan. 13, 1997, at 608.

24. Daniel Machalaba, *Conrail's Breakup Plan is Released by Norfolk Southern, CSX Corp.*, *Wall St. J.*, April 9, 1997, at B4.

25. *Id.*; Don Phillips, *Railroads Agree to Meet to Resolve Conrail Dispute*, *Wash. Post*, Jan. 21, 1997, at C1.

26. Phillips, *supra* note 25, at C1.

27. See discussion *infra* Parts I.B.1-I.B.6.

This Note assesses the role the Pennsylvania anti-takeover provisions played in the Conrail merger and argues that the Conrail merger is an excellent example of (1) why complicated state anti-takeover provisions are counter-productive and (2) why states that pass anti-takeover legislation should not do so without considering the myriad of possible applications. Part I examines the evolution of state anti-takeover statutes and describe their application in situations where hostile bidders attempt to acquire local companies through a variety of methods. Part II analyzes Pennsylvania's unique legislative approach and its impact on the Conrail merger negotiations. Part III first argues that the Conrail saga is an example of complex anti-takeover statutes being counter-productive, and second, that hastily passed anti-takeover legislation fails to account for corporate complexity. This Note concludes that legislatures should consider four important factors when contemplating anti-takeover legislation, and that a simpler approach more effectively accommodates the legislative intent behind the provisions, while still protecting shareholder interest in maximizing wealth.

## I. THE EVOLUTION OF STATE ANTI-TAKEOVER STATUTES

Part I discusses the development of federal regulation of securities markets and the state legislation that was intended to supplement federal control. Part I.A discusses the federal and state regulation of securities markets, particularly with respect to tender offers. Part I.B then describes various types of state anti-takeover provisions and their intended application.

### A. *State Response to Federal Regulation of Securities Markets*

The federal government took an active role in corporate affairs with Congressional passage of the Securities Act of 1933,<sup>28</sup> and the Securities Exchange Act of 1934.<sup>29</sup> Although this legislation was intended to regulate, among other things, corporate ownership changes, cash tender offers<sup>30</sup> fell into a regulatory gap because they did not involve the issuance of securities or the solicitation of proxies. Although proxy contests were the primary means by which shareholders could oust incumbent management in the 1950s and 1960s,<sup>31</sup> cash tender of-

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28. 15 U.S.C. § 77 (1992).

29. 15 U.S.C. § 78 (1992).

30. "Tender offer" does not have a precise definition. See Lewis D. Solomon, et. al., *Corporations: Law & Policy* 1065 (2d ed., West Publishing Co. 1988). It is most commonly defined as a highly publicized offer to all shareholders to purchase their shares at a premium above market. See *id.* There are, however, a variety of situations with special circumstances that fall within the "tender offer" ambit. See *id.*

31. P.R. Chandy, et. al., *The Shareholder Wealth Effects of the Pennsylvania Fourth Generation Anti-Takeover Law*, 32 Am. Bus. L. J. 399, 403-04 (1995). A "proxy contest" provides shareholders a choice in the selection of directors, and ultimately in management. See Solomon, *supra* note 30, at 1040. Shareholders receive proxy state-

fers began to replace them in the 1960s.<sup>32</sup> As a result of this inadequacy in the regulatory scheme, Congress passed the Williams Act in 1968.<sup>33</sup> The Williams Act was intended to protect investors confronted with a cash tender offer by ensuring that they receive sufficient and timely information with respect to the offer.<sup>34</sup> Regardless of the new burdens that the Williams Act placed on bidders, the protection was less than management sought<sup>35</sup> and tender offers activity continued to escalate.<sup>36</sup>

Despite these efforts by the federal government to protect the integrity of the securities markets, many state legislatures felt Congress failed to provide adequate refuge from hostile bidders and passed increasingly aggressive anti-takeover statutes.<sup>37</sup> In most instances, the obvious intent of the state legislation was to protect incumbent management and to ensure that local companies which were potential takeover candidates remained intact along with their significant payrolls.<sup>38</sup> The statutes were effective because they imposed additional impediments to a takeover and, thus, inhibited or slowed any takeover transaction.<sup>39</sup> State legislatures were required to comply with the Supreme Court's mandate that such legislation "avoid favoring either management or the takeover bidder,"<sup>40</sup> while still protecting corporations from foreign<sup>41</sup> hostile bidders whose acquisitions were often fol-

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ments and proxy voting forms from different slates of candidates; usually one is favored by incumbent management and the other is favored by challengers. *See id.* The goal of a proxy contest is to win the voting support of the shareholders. *See id.*

32. Fabricant, *supra* note 19, at 30.

33. 15 U.S.C. §§ 78m(d)-(e), 78n(d)-(f) (1992). The Williams Act added §§ 13(d), 13(e), and 14(d)-(f) to the Securities Act of 1934 to control the tender offer process. *See Chandy, supra* note 31, at 404.

34. Fabricant, *supra* note 19, at 30.

35. *Id.* (citing S. Rep. No. 90-550, at 3 (1967)).

36. Fabricant, *supra* note 19, at 30.

37. Anti-takeover statutes refer to legislation passed to protect management from hostile takeovers. *See Fabricant, supra* note 19, at 30. For a breakdown of state legislation in effect as of Aug. 1, 1992, see 3 State Takeover Statutes and Poison Pills: Shark Repellents and Golden Parachutes, 8-14 (Robert H. Winter et. al. eds., Supp. 1992) [hereinafter "Poison Pills"]; *see also* Jeffrey L. Silberman, Note, *How Do Pennsylvania Directors Spell Relief?* Act 36, 17 Del. J. Corp. L. 115, 121-28 (1992) (noting the development of state anti-takeover provisions and the "generation" categories, discussed *infra* at notes 44-57). Most state anti-takeover provisions were passed at the behest of local corporate management, eager to thwart hostile takeovers. Fabricant, *supra* note 19, at 32.

38. James D. Cox et. al., 3 Corporations §24.8, at 24.50 (1995).

39. *Id.*

40. *Edgar v. MITE Corp.*, 457 U.S. 624, 633 (1982) (White, J., plurality opinion); *see also* S. Rep. No. 90-550, at 2-4 (1967) (discussing the role of cash tender offers in corporate law and the importance of maintaining a level playing field between bidders and target company management).

41. In this context, "foreign" refers to out-of-state bidders.

lowed by costly liquidations.<sup>42</sup> In reality, however, "most state anti-takeover acts make no pretense of such even-handedness."<sup>43</sup>

State anti-takeover statutes have undergone extensive revision since their inception.<sup>44</sup> The first generation of state legislation followed the pattern of existing state securities laws, and "went beyond the disclosure philosophy of the Williams Act by giving a state administrator the power to review the merits of the tender offer's terms . . . ."<sup>45</sup> These statutes often imposed waiting periods between the filing of the tender offer and the date on which it was to become effective.<sup>46</sup> In 1982, the Supreme Court, in *Edgar v. MITE Corp.*,<sup>47</sup> first reviewed this type of statute. In *MITE*, the Court declared unconstitutional an Illinois anti-takeover statute that imposed a waiting period and provided for a hearing on the tender offer's terms.<sup>48</sup> The decision rested on the Court's finding that the Illinois law violated the Commerce Clause because it impermissibly burdened interstate commerce by attempting to protect nonresident shareholders and by affecting out-of-state transactions.<sup>49</sup> Also, a plurality found that the law violated the

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42. See *infra* notes 95-114 and accompanying text concerning the debate regarding the motivation behind the anti-takeover legislation. Anti-takeover laws became popular during the merger and acquisition craze of the 1980s. See Patrick S. McGurn & Mary F. Spatola, *State Takeover Laws 1* (Investor Responsibility Research Center 2d ed. 1995). Out-of-state bidders would finance a hostile tender offer by incurring tremendous debt. *Id.* at 1-2. Once acquiring a controlling interest of the company, they would begin a liquidation process to finance the interest payments and repay the loans. *Id.* This transaction, known as a leveraged buy-out (LBO), became a favorite technique of corporate raiders. *Id.*

43. Cox, *supra* note 38, § 24.8, at 24.50. This is in contrast to the Williams Act, which may be viewed as "maintaining a level playing field between the bidder and the target corporation's shareholders." *Id.*

44. State statutes have been challenged on a variety of grounds. See, e.g., *CTS Corp. v. Dynamics Corp. of Am.*, 481 U.S. 69, 94 (1987) (holding that Indiana's control share acquisition statute was constitutionally permissible); *Edgar v. MITE Corp.*, 457 U.S. 624, 646 (1982) (holding that Illinois Business Takeover Act was unconstitutional). As a result of these judicial decisions, states found acceptable parameters for anti-takeover legislation. See Silberman, *supra* note 37, at 121-28. No state anti-takeover law has been overturned or successfully contested since *Edgar v. MITE*. See Steven Lipin & Anna W. Mathews, *Conrail Fight May Hinge on Pennsylvania Law*, *Wall St. J.*, Oct. 28, 1996, at C1. In fact, recent decisions have upheld anti-takeover statutes that prevented a bidder from any possibility of making a successful offer. See e.g., *Amanda Acquisition Corp. v. Universal Foods Corp.*, 877 F.2d 496 (7th Cir. 1989) (upholding a Wisconsin business combination statute), *cert. denied*, 493 U.S. 955 (1989).

45. Cox, *supra* note 38, at § 24.8, at 24.51-24.52; see, e.g., N.J. Stat. Ann. § 49:5-4a (West Supp. 1994); see also *Kennecott Corp. v. Smith*, 507 F. Supp. 1206, 1217 (1981) (holding that New Jersey takeover law frustrates the purpose of the Williams Act by substituting bureau chief's view of the offer for the informed judgment of shareholders).

46. See, e.g., Conn. Gen. Stat. Ann. § 36b-44(a) (West 1996); Del. Code Ann. tit. 8, § 203(a)(1) (1983) (repealed); 70 Pa. Cons. Stat. Ann. § 74(a) (West 1994).

47. 457 U.S. 624 (1982).

48. *Id.* at 646.

49. *Id.* at 643-46.



Supremacy Clause because it conflicted with the Williams Act's implicit requirement of evenhandedness.<sup>50</sup>

Following *MITE*, states created "second generation" statutes which purported to regulate only the internal affairs of domestic corporations.<sup>51</sup> These statutes took various forms, including "control share acquisition" statutes,<sup>52</sup> "fair value" statutes,<sup>53</sup> and other constituencies statutes.<sup>54</sup> In 1987, the Supreme Court in *CTS Corp. v. Dynamics Corp. of America*<sup>55</sup> upheld an Indiana control share statute,<sup>56</sup> thus quelling any fears that similar second generation anti-takeover statutes would be deemed unconstitutional.

After the United States Supreme Court opened the door with the *CTS* decision, many states created a third generation of anti-takeover statutes that were more aggressive than their predecessors.<sup>57</sup> Most of these statutes were intended to delay any transaction that would complete the second step of a two-step acquisition where the first step was not agreed to by the target company's management.<sup>58</sup> Pennsylvania passed legislation in 1990<sup>59</sup> that is considered to have inaugurated the fourth generation of anti-takeover provisions.<sup>60</sup>

### B. State Statutes and Accompanying Provisions

Most states have generally incorporated one or more of six different approaches to dealing with takeover situations: control share acquisition statutes, business combination statutes, fair price statutes, cash-out statutes, other constituencies statutes, and disgorgement provisions.<sup>61</sup>

#### 1. Control Share Acquisition Statutes

Control share acquisition statutes<sup>62</sup> require a person seeking to purchase a certain controlling amount of target stock<sup>63</sup> to obtain

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50. *Id.* at 630-34.

51. See Fabricant, *supra* note 19, at 33.

52. Discussed and defined *infra* at note 62.

53. Discussed and defined *infra* at note 83.

54. Discussed and defined *infra* at note 74.

55. *CTS Corp. v. Dynamics Corp. of Am.*, 481 U.S. 69 (1987).

56. *Id.*

57. Cox, *supra* note 38, § 24.8, at 24.58.

58. *Id.* The business combination statute, see *infra* note 74, is an example of this type of provision. *Id.*

59. See *infra* note 114.

60. Silberman, *supra* note 37, at 117.

61. Poison Pills, *supra* note 37, at 4-5.

62. Control share acquisition statutes have been adopted, in varying forms by many states. See Poison Pills, *supra* note 37, at 15; see e.g., Ariz. Rev. Stat. Ann. § 10-2721 (West 1996); Fla. Stat. Ann. § 607.0902 (West 1993); Ind. Code. Ann. §§ 23-1-42-1 to -11 (Michie 1995).

63. The exact threshold at which control is deemed to be acquired is defined by statute. For example, Indiana sets the threshold at 20%. Ind. Code Ann. § 23-1-42-1(1) (Michie 1995).

shareholder approval of the proposed transaction in order to exercise the voting power of the acquired stock.<sup>64</sup> In most states with this type of provision, the offeror may acquire the shares without shareholder approval, but the acquired shares will be held without voting rights.<sup>65</sup> Sometimes, shareholder approval is required for the acquisition regardless of whether the shares are acquired with voting rights.<sup>66</sup> Administering this type of provision requires the offeror to submit a statement disclosing his intent to acquire the "control" block.<sup>67</sup> This, in turn, will prompt a special shareholder meeting to vote on the proposal and give shareholders an opportunity to avail themselves of appraisal rights<sup>68</sup> in the event the proposal is approved.<sup>69</sup>

The purpose of this type of provision is to give current shareholders an opportunity to vote on a proposed acquisition of control.<sup>70</sup> Like much of the anti-takeover legislation, this is premised on the notion that individual shareholders are often disadvantaged when confronted with a tender offer.<sup>71</sup> By permitting the shareholders to act together, these provisions aim to eliminate the coercion presented in two-tier front loaded offers<sup>72</sup> by forcing the bidder to disclose its post-acquisition plans.<sup>73</sup>

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64. See *Poison Pills*, note 37, at 4.

65. *Id.* at 15.

66. *Id.*

67. Martin Lipton & Erica H. Steinberger, 1 *Takeovers & Freezeouts* § 5.03[1], at 5-29 (1997). A control block is the exact threshold at which control is deemed to be acquired, as defined by statute. See *supra* note 63.

68. The appraisal remedy permits shareholders to dissent from a transaction that involves a fundamental corporate change—i.e., a merger—and insist on being paid in cash the value of their shares as determined by appraisal. Solomon et al., *supra* note 30, at 957.

69. Lipton & Steinberger, *supra* note 67, § 5.03[1], at 5-30.

70. See *Poison Pills*, *supra* note 37, at 15.

71. *Id.* All tender offers, to some degree, pressure shareholders to accept whatever premium is offered in the takeover bid. *Id.* at 15-16. If the target shareholders believe that a successful initial tender will be followed by a purchase of non-tendered shares at a price lower than that offered in the initial bid, shareholders may tender their shares even if they do not believe the offer to be in their best interests. *Id.*

72. A "two-tier" takeover bid generally involves a strategy where the bidder tenders for 50%—or at least enough stock to take *de facto* control—at one price, but at the outset it is clear that once it obtains control, it will merge out the remaining shareholders at a lower price. See Klein & Coffee, *supra* note 14, at 184. Those who wait for the "back end" will be worse off than those who tender into the early offer. *Id.* Resistance to the tender offer is subdued because the two-tier offer creates a competition among shareholders for the "front end" offer. *Id.* Even if the shareholder is dissatisfied with the front end, they fear being left with an even more dissatisfying back end, and therefore, tender. *Id.*

73. See *Poison Pills*, *supra* note 37, at 16.

## 2. Business Combination Statutes

Business combination statutes<sup>74</sup> prevent a target's management from engaging in any business combination<sup>75</sup> for a designated period of time after a shareholder acquires a certain amount of the target's outstanding shares.<sup>76</sup> This type of provision is intended to thwart highly-leveraged takeover bids referred to as "leveraged buy-outs,"<sup>77</sup> in which the target's assets are used as collateral for the offeror's debt financing.<sup>78</sup> Often, after the acquisition, the acquirer is forced to liquidate assets of the now-acquired target in order to generate cash to meet the interest payments generated by the debt.<sup>79</sup> These acquisitions typically involve some type of business combination soon after the transaction.<sup>80</sup>

Most business combination provisions allow an offeror to make a good faith plea to the board of directors to approve a post-acquisition strategy.<sup>81</sup> Also, most states use this provision in tandem with a fair price provision, discussed below.<sup>82</sup>

## 3. Fair Price Statutes

Fair price statutes<sup>83</sup> require that the same price be paid to all shareholders who tender their shares, regardless of whether they partici-

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74. Currently, many states have adopted business combination statutes. *Poison Pills*, *supra* note 37, at 27; *see e.g.*, Ariz. Rev. Stat. Ann. §§ 10-2741 - 10-2743 (West 1996); Ga. Code Ann. §§ 14-2-1131 - 14-2-1133 (1994); Ind. Code Ann. §§ 23-1-43-1 - 23-1-43-24 (Michie 1995).

75. Business combinations are broadly defined to include mergers, sales of assets, liquidations, recapitalizations, and various kinds of self-dealing transactions. *See* Lipton, *supra* note 67, at 5-26. The statutes are intended to "delay any transaction that would complete the second step of a two-step acquisition where the first step was not agreed to by target company's management." Cox, *supra* note 38, at 24.58.

76. *Poison Pills*, *supra* note 25, at 4. These statutes are intended to prevent takeover bids financed by high-yield debt, which often requires target assets to be sold to repay offeror's debt and recoup profits. *Id.*

77. While an LBO can take many forms, it is essentially the "[a]cquisition of a business in a transaction where the purchaser's equity risk is small in relation to the purchase price and most of the purchase price is provided by borrowings from one or more outside lenders." Harvey E. Benjamin & Michael B. Goldberg, *Leveraged Acquisitions & Buyouts* 11 (1986); *see supra* note 42. In some transactions, part of the debt is financed by the company itself, in the form of a deferred purchase price. Benjamin & Goldberg, *supra*, at 11.

78. *See* Solomon, *supra* note 30, at 1062.

79. *See* Fabricant, *supra* note 19, at 30. The lenders look to the assets and/or cash flow of the acquired business as the source of repayment of the loans, as opposed to looking to the purchaser. Benjamin & Goldberg, *supra* note 77, at 11.

80. *See* *Poison Pills*, *supra* note 37, at 28.

81. *Id.* at 28-29.

82. *Id.* at 30.

83. Many states have adopted fair price statutes and, in addition, several have business combination statutes which contain a fair price component. *Id.* at 42; *see e.g.*, Fla. Stat. Ann. §§ 607.0901, 607.0903 (West 1993 & Supp. 1998); Ga. Code Ann. §§ 14-2-1110 to 14-2-1113 (1994).

pate in the first or second tier or a multi-tiered offer.<sup>84</sup> These provisions are intended to protect minority shareholders from being mistreated in the back-end stage of a two-tier acquisition.<sup>85</sup> Their effect is limited to transactions in which a large shareholder seeks to consolidate its control over the company, which will result in the minority shareholders being squeezed out—e.g., merger, sale, liquidation,<sup>86</sup> recapitalization,<sup>87</sup> or minority buy-out.<sup>88</sup> In these scenarios, minority shareholders are often forced to accept a lesser price than originally paid by the offeror for the control portion of the stock.<sup>89</sup> Because minority shareholders know they will eventually be forced to sell their stock if a majority tender into the original offer, they will be induced to “take the money and run” and tender into the original offer. The objective of this provision was to protect shareholders from being coerced into tendering into this type of two-tiered bid by providing that every shareholder tendering into the offer will receive the same compensation for their shares.<sup>90</sup>

#### 4. Cash-Out Statutes

Cash-out statutes<sup>91</sup> require that if an offeror purchases a certain amount of stock, it must then offer to purchase the remaining shares of all other stock at a price which reflects the highest premium<sup>92</sup> paid

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84. Poison Pills, *supra* note 37, at 4.

85. *Id.* at 41. Shareholders are protected from being either coerced into tendering into the front-end of the offer, or being forced to accept an inferior back-end amount. See Klein & Coffee, *supra* note 14, at 183-86, 194.

86. See Solomon, *supra* note 30, at 419-20:

The liquidation of an enterprise is . . . the reduction of its assets to cash or some other “liquid” form. While it usually implies the cessation of a corporation’s normal business operation, it does not necessarily involve dissolution; the corporation may remain a ‘shell’ whose sole function is to own the now liquid assets.

87. See William L. Cary & Melvin A. Eisenberg, Corporations: Cases and Materials 1268 (6th ed. 1988) (“A recapitalization is a material readjustment in the relative rights, preferences, and privileges of a corporation’s various classes of stock.”).

88. Also known as a “freeze out,” a minority buy out is a corporate transaction that reconstitutes the corporation’s ownership by involuntarily eliminating the equity interest of minority shareholders. *Id.* at 1168. The dominant shareholder purchases the shares of the minority holders, usually for cash or fixed income securities, where the dominant shareholder has the votes to cause the transaction to occur. Solomon, *supra* note 30, at 1061.

89. See *supra* note 72 & accompanying text.

90. *Id.*

91. This type of statute is only currently in force in Maine and Pennsylvania. See Poison Pills, *supra* note 37, at 51; see e.g., Me. Rev. Stat. Ann. tit. 13-A, § 910 (West Supp. 1997); 15 Pa. Cons. Stat. Ann. §§ 2541-2548 (West 1995).

92. This premium refers to the difference between the market price of the stock and the tender offer which is generally higher than the market price. Solomon, *supra* note 30, at 1052. This greater-than-market bid is, primarily, what encourages shareholders to tender their shares. *Id.*

by the offeror in accumulating his initial block of target stock.<sup>93</sup> Cash-out statutes, like the other provisions, are intended to permit shareholders to dissent from a large stock acquisition that may confer control upon an acquirer.<sup>94</sup> By guaranteeing the opportunity to cash out at the fair value of their shares, shareholders are protected against the coercive nature of tender offer schemes.<sup>95</sup>

Notice of a "control" acquisition that would activate the provision must be given to the shareholders of record.<sup>96</sup> After the notice, the shareholder may make a written demand on the control group for payment in cash for those shares.<sup>97</sup> Cash-out statutes force the offeror, as opposed to the target company, to purchase the shares of dissenting shareholders.<sup>98</sup>

## 5. Other Constituencies Statutes

Other constituencies statutes,<sup>99</sup> often referred to as "nonmonetary factors statutes," permit directors to consider interests other than the tender offer price in determining whether or not to accept a bid.<sup>100</sup> This type of provision is intended to give corporate boards the leeway to reject superior monetary bids if management believes that the bidder would not serve the best overall or long-term interests of the company.<sup>101</sup> This type of provision supports the notion that a corporation is responsible not only to its shareholders, but to its relationships with the community at large.<sup>102</sup> Often, corporate acquisitions and mergers result in layoffs and plant closings which have a devastating effect on local economies.<sup>103</sup> By preventing the takeover, shareholders may be

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93. See *Poison Pills*, *supra* note 37, at 4. For example, if a hostile bidder acquired 20% of a target company's stock, and the state statute defined 20% as the threshold amount that activates the provision, the remaining 80% shareholders would be entitled to sell their stock to the hostile bidder for the highest amount it paid for the original 20%.

94. See *Poison Pills*, *supra* note 25, at 51.

95. *Id.* ("[T]he statutes are intended to limit the perceived coercive effect . . . of two-tier and partial tender offers and so-called 'creeping tender offers,' in which a large block [of stock] is purchased on the open market, and to assure that all shareholders will share in the control premium paid by the Offeror."); Chandy, *supra* note 31, at 411 (The statute was passed "in order to discourage two-tier, front-loaded tender offers.").

96. *Poison Pills*, *supra* note 37, at 52.

97. *Id.*

98. *Id.*

99. Other constituency statutes have been adopted by a large number of states. See *Poison Pills*, *supra* note 37, at 55. See e.g., Iowa Code Ann. § 490.1108 (West 1991); Ky. Rev. Stat. Ann. § 271B.12-210(4) (Michie Supp. 1996); Mass. Ann. Laws ch. 156B, § 65 (Law Co-op Supp. 1997); Nev. Rev. Stat. Ann. § 78.138 (Michie 1994); N.Y. Bus. Corp. Law § 717(b) (McKinney Supp. 1996).

100. See *Poison Pills*, *supra* note 37, at 5.

101. *Id.*

102. *Id.*

103. See *infra* note 136 and accompanying text. The Conrail break up between CSX and Norfolk provides a good example. The joint application submitted to the

denied a profitable bid, but the negative impact on the community will be avoided. Despite this provision, other constituencies statutes do not place the community's interests above that of the shareholders. Instead, these statutes are drafted so that shareholder interests are no longer considered the primary concern, but are now one of many interests the board must consider.<sup>104</sup>

## 6. Disgorgement Provisions

Disgorgement provisions<sup>105</sup> permit corporations, under certain circumstances, to obtain "short-swing" profits<sup>106</sup> from a shareholder that were realized from the sale of stock after the company is put "in play."<sup>107</sup> This type of provision is a legislative effort to discourage arbitrageurs<sup>108</sup> and speculators whose trading activities in the target company's stock often forces a company into a hostile takeover situation.<sup>109</sup> When a company has been put "in play," arbitrageurs' increased buying of the target stock will bid up the price.<sup>110</sup> Before the

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Surface Transportation Board covering the breakup forecasts severe job cuts in Philadelphia. See John George, *No Surprise: Conrail Breakup Brings Job Cuts*, Phila. Bus. J., June 27, 1997, at 3. The break up will result in a net loss of 1623 mostly administrative and clerical positions. *Id.* The real impact goes much further, however. For example, when Gulf Corporation was acquired by Standard Oil Company of California, people feared the economy would be negatively impacted in a variety of ways. See Roberta Romano, *The Political Economy of Takeover Statutes*, 73 Va. L. Rev. 111, 121 (1987) (citing Thomas F. O'Boyle & Susan Carey, *Gulf's Departing Pittsburgh Would Deal a Harsh Blow to City's Economy and Pride*, Wall St. J., March 9, 1984, at 33). Donations to local charities were expected to decline, as was revenue from personal and corporate property taxes. *Id.* Concerns even arose regarding loss of revenue from local messenger services. *Id.*

104. The Delaware Supreme Court gave some judicial credence to this approach in *Paramount Communications, Inc. v. Time Inc.*, 571 A.2d 1140, 1153 (Del. 1989); see *infra* notes 285-86 and accompanying text.

105. Disgorgement provisions have been adopted by Ohio and Pennsylvania. See *Poison Pills*, *supra* note 37, at 59. See e.g., Ohio Rev. Code Ann. § 1707.043 (Anderson 1992); 15 Pa. Cons. Stat. Ann. §§ 2571-2576 (West 1995).

106. Short swing profits are defined in the Pennsylvania statute as profit realized upon the disposition—i.e., sale—of the corporation's equity securities if the disposition occurs within 18 months after the person or group became a controlling person or group, and the equity securities were acquired within 24 months before or 18 months after the person or group became a controlling person or group. 15 Pa. Cons. Stat. Ann. § 2575 (West 1995); see *Poison Pills*, *supra* note 37, at 60.

107. *Poison Pills*, *supra* note 37, at 5. Pennsylvania was one of the first states to introduce this type of provision in the 1990 legislation. *Id.*

108. Arbitrageurs, or "arbs," are professional risk-takers—often brokers who purchase shares from the public at a price below the tender offer price, with the expectation that they will tender to the bidder at the higher price and make a profit on the spread. Solomon, *supra* note 30, at 1058. The spread exists due to the risk that the target company will prevent the consummation of the tender offer and send the price back to its pre-tender offer level. *Id.* "The arbitrageur assumes the risk of failure of the offer in return for the expected profit." *Id.*

109. See *Poison Pills*, *supra* note 37, at 59.

110. See Solomon, *supra* note 30, at 1058. The market assumes the company will be acquired, if not by the bidder, then by another bidder, or the company will acquire all

smoke settles, arbitrageurs will sell the stock, making a quick profit, and leaving long-term shareholders to suffer the consequences. When raiders put a company in play, they create a "death dance on that corporation."<sup>111</sup> The company often fights back by shutting down or selling off assets.<sup>112</sup> Management's attention is drawn away from running the business as they cope with the looming crisis and the focus shifts from long-term development to short-term results.<sup>113</sup>

States have adopted various combinations of the above statutes. Each works to thwart unwelcome takeovers of local companies and ensure that shareholders are not unreasonably coerced into accepting an inadequate offer for their shares.

## II. CSX'S BATTLE FOR NORFOLK IN PENNSYLVANIA FOR CONTROL OF CONRAIL

Part II discusses Pennsylvania's adoption of the various anti-takeover statutes discussed above. Part II.A reviews the legislation with a specific focus on the fair price provision and the other constituencies provision. Part II.B assesses the provisions' impact on the Conrail negotiations.

### A. Pennsylvania's Anti-Takeover Statute

Pennsylvania passed an aggressive statute in 1990<sup>114</sup> that involved several of the above anti-takeover techniques.<sup>115</sup> It has been observed that "no prior state anti-takeover law [is] as broad or as protective,"<sup>116</sup>

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or most of its own stock for debt securities or cash. *Id.* In either event, there is an expectation that shareholders will be able to sell out at a large profit. *Id.*

111. Patty Tascarella, *Pennsylvania's Anti-Takeover Law Was Intended to Derail Greenmailers*, Business Dateline, September 1990, Vol. 9; No. 1; Sec. 1; at 22 (quoting Bill George, then legislative director of the United Steelworkers of America).

112. *Id.*

113. *Id.*

114. Act of April 27, 1990, No. 36, 1990 Pa. Laws 36 (codified at 15 Pa. Cons. Stat. Ann. §§ 102, 511-12, 1721, 2502, 2542, 2561-67, 2571-76, 2581-83, and 2585-88 (West 1995)). It is commonly referred to as a fourth generation statute. See Part I.A.; Chandy, *supra* note 31, at 405 n.39.

115. Pennsylvania's anti-takeover statute includes the following:

15 Pa. Cons. Stat. Ann.

Exercise of Powers Generally	§ 1715
(Other Constituency)	
Approval of Transactions with Interested Shareholders	§ 2538
(Fair Price)	
Control Transactions (Cash-Out)	§§ 2541-2548
Business Combinations	§§ 2551-2556
Control-Share Acquisitions	§§ 2561-2567
Disgorgement	§§ 2571-2576
Employment Related Provisions	§§ 2581-2583, 2585-2588

See Poison Pills, *supra* note 37, at 13.

116. Chandy, *supra* note 31, at 413. More than forty states have adopted some form of anti-takeover statute. See John H. Matheson & Brent A. Olson, *Shareholder*

and there was fierce criticism of the Act.<sup>117</sup> The statute did contain opt out provisions<sup>118</sup> for each section which allowed companies, under certain circumstances, to avoid being bound by the legislation.<sup>119</sup> Many companies immediately opted out after passage of the Act.<sup>120</sup> Opponents charged that it would virtually strip shareholders of their ability to challenge corporate management and would drive investors away from Pennsylvania companies.<sup>121</sup> The Pennsylvania statute involved more defensive mechanisms than the legislation of other states,

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*Rights and Legislative Wrongs: Toward Balanced Takeover Legislation*, 59 Geo. Wash. L. Rev. 1425, 1439 (1991). For a discussion of the different types of anti-takeover statutes that states have adopted, see *id.* at 1439-52; Richard A. Booth, *The Promise of State Takeover Statutes*, 86 Mich. L. Rev. 1635, 1670-81 (1988).

117. McGurn & Spatola, *supra* note 42, at Pennsylvania-6. The bill was also known as "The Fat Cat Protection and Shareholder Rip-Off Act" because its provisions made ousting poor management more difficult. See Tascarella, *supra* note 111, at 22.

118. Opt out provisions enable a company, by following specified procedures, to choose not to be bound by particular anti-takeover provisions. Poison Pills, *supra* note 37, at 77.

119. See e.g., 15 Pa. Cons. Stat. Ann. § 2561 (West 1995) (allowing a corporation to opt out of the control share acquisition provision with a bylaw amendment adopted by the board within 90 days after the date of passage—i.e., by July 26, 1990—or in the original charter, or by charter amendment within 90 days after a company becomes eligible for coverage); *id.* at § 2541 (allowing a corporation to opt out of the control share cash out provision); *id.* at § 2551 (allowing a corporation to opt out of the business combination provision); *id.* at § 2571 (allowing a corporation to opt out of the disgorgement provisions).

Opt out provisions are common in state anti-takeover statutes. See Poison Pills, *supra* note 37, at 77. Corporations were given a 90-day period following enactment of the provisions to opt out of all or any of them by, among other measures, enacting a bylaw amendment adopted by the board of directors. See e.g., 15 Pa. Cons. Stat. Ann. § 2571 (West 1995) (opt out procedures for disgorgement provision).

120. Although most Pennsylvania companies supported the legislation, many chose to opt out after its passage. Michael W. Armstrong, *At Least 67 Firms Buck Act 36*, Philadelphia Bus. J., July 30, 1990, at 1. It is difficult to assess the exact number of companies that chose to opt out because there is no legal requirement for companies to report their opt out to the state. *Id.* More than 65 of Pennsylvania's publicly traded corporations (about 21%) chose to opt out of all or a part of this statute. *Id.*; see also Vindu P. Goel, *Many Top Pennsylvania Firms Opt Out of Provisions in State Anti-Takeover Law*, Wall St. J., July 27, 1990, at A3 (discussing the irony of companies first supporting the legislation and then opting out); Justin P. Klein & Jeffrey P. Greenbaum, *Companies Cool Toward Anti-Takeover Law*, N.Y. L.J., Sept. 10, 1990, at 15 (discussing the many companies that chose to opt out of anti-takeover statutes).

121. Silberman, *supra* note 37, at 152-53 & n.236; McGurn & Spatola, *supra* note 42, at Pennsylvania-6. Four subsequent studies reported that the Pennsylvania takeover law caused a significant decline in the prices of Pennsylvania stock. *Id.* at Pennsylvania-7. For example, Wilshire Associates released two studies of the law's impact on April 23 1990 which reported that shareholders lost over \$1 billion in the five months following the introduction of the Pennsylvania legislation and predicted that losses would be higher if the legislation was enacted and enforced. *Id.* at Pennsylvania-7-8. Wilshire incorporated 47 factors known to affect stock price to estimate where Pennsylvania stock prices should have been during the relevant period. *Id.* at Pennsylvania-8. "When stock prices deviated from the predicted price, Wilshire attributed that movement to the Pennsylvania law." *Id.*



and certain provisions moved many to declare it the most aggressive.<sup>122</sup>

In 1992, shareholders of Armstrong World Industries challenged the Pennsylvania statute on constitutional grounds before the U.S. Court of Appeals for the Third Circuit.<sup>123</sup> In *Armstrong World Indust. Inc. v. Adams*,<sup>124</sup> the Third Circuit dismissed the action for failure to present "a case or controversy."<sup>125</sup> The case was brought immediately after the statute took effect, and Judge Anthony Scirica held that none of the statute's provisions had been triggered.<sup>126</sup> No further actions were brought and, in light of the Supreme Court's trend towards liberalizing state authority to implement anti-takeover provisions,<sup>127</sup> it is doubtful a court would find the provisions unconstitutional.

Only two of the Pennsylvania statute's provisions were relevant to the Conrail negotiations.<sup>128</sup> Each provision had a different legislative objective, and both impacted the results of the bidding contest. The two provisions at the center of the CSX/Norfolk conflict were the fair price provision, and the other constituencies provision.

### 1. Fair Price Provision

Pennsylvania's fair price provision guarantees shareholders the right to obtain, from a bidder acquiring more than 20%<sup>129</sup> of the voting securities of a registered Pennsylvania corporation, the highest price the bidder paid for the shares within the 90-day period ending

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122. See Silberman, *supra* note 37, at 117; see also Klein & Greenbaum, *supra* note 120, at 15 (noting that Pennsylvania's legislation was the most aggressive); Leslie Wayne, *Takeovers Face New Obstacles*, N.Y. Times, Apr. 19, 1990, at D1 (discussing the impact of Pennsylvania's new anti-takeover legislation).

123. *Armstrong World Indus. Inc. v. Adams*, 961 F.2d 405 (3d Cir. 1992) (holding that the controversy is not ripe).

124. *Id.*

125. *Id.* at 424. This affirmed the lower court's dismissal of the action. *Id.*

126. *Id.*

127. See *supra* note 44 and accompanying text.

128. This paper will discuss the impact of the fair price provision and the other constituencies provision on the Conrail merger. The statute, however, also contains other anti-takeover provisions. See *supra* note 115 & accompanying text.

129. The 20% threshold is used to define a "controlling person." 15 Pa. Cons. Stat. Ann. § 2543(a) (West 1995). There are listed exceptions to the 20% threshold. *Id.* at § 2543(b)-(c). The corporation can opt out of this subchapter. *Id.* at § 2541. Further exceptions attempt to exclude natural persons who do not appear to have acquired stock in an effort to gain control over the company. See *id.* at § 2543. This includes long-standing shareholders, shares acquired by gift, inheritance, bequest, etc., shares acquired pursuant to stock splits, dividends, or reclassifications, and shares that do not include voting rights. *Id.* An exception also covers stock acquired directly from the corporation or with the consent of the corporation. *Id.* For a more detailed explanation of the intricacies of the Pennsylvania statute, see James F. Nasuti & Jeffrey B. Rotwitt, *The Pennsylvania Corporation: Legal Aspects of Organization and Operation*, 30 Corp. Prac. Series 2d. (BNA) (May 21, 1997).

on and including the date the bidder acquired 20% ownership.<sup>130</sup> If the shareholders do not receive the highest price paid, then the transaction will require approval from the shareholders, not including the bidder.

## 2. Other Constituencies

Corporate directors have a fiduciary relationship<sup>131</sup> to their corporations and are held to the standard of care that ordinarily prudent persons would exercise under similar circumstances.<sup>132</sup> "Directors are required to devote themselves to corporate affairs with a view to promoting the common interest of all shareholders."<sup>133</sup> Pennsylvania law, prior to 1990, provided that directors owed a primary fiduciary duty to shareholders, although directors could consider other factors when contemplating the future direction of the corporation.<sup>134</sup> This was consistent with traditional corporate notions of fiduciary duty.<sup>135</sup>

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130. 15 Pa. Cons. Stat. Ann. §§ 2541-48 (West 1995). This provision is activated when a "control transaction" occurs. *Id.* "Control transaction" is defined in § 2542 as the "acquisition by a person or group of the status of a controlling person or group." *Id.* at § 2542. "Controlling person or group" is defined within § 2543(a) as a holder of at least 20% of the votes that all shareholders would be entitled to cast in an election of directors. *Id.* at § 2543(a). The shareholder right to demand the highest price the bidder has offered for all of the shares is outlined in § 2546(c). *Id.* at § 2546(c). "Fair value" is defined in § 2542 as "a value not less than the highest price paid per share by the controlling person or group at any time during the 90-day period ending on and including the date of the control transaction plus an increment representing any value, including, without limitation, any proportion of any value payable for acquisition of control of the corporation, that may not be reflected in such price." *Id.* at § 2542.

131. "Although the directors are not agents of the shareholders in the legal sense, they are considered to be quasi-trustees who are subject to 'fiduciary duties' owed to the corporation; in essence, these duties amount to the same kind of duty of loyalty and duty of care that an agent owes to his or her principal." Klein & Coffee, *supra* note 14, at 126. Although corporate boards have tremendous discretion, they are traditionally guided by the principle that their role is to generate profit for stockholders. *Dodge v. Ford Motor Co.*, 170 N.W. 668, 684 (Mich. 1919). Traditionally, shareholders are considered owners who have an absolute property right in the corporate entity. See Steven M.H. Wallman, *The Proper Interpretation of Corporate Constituency Statutes and Formulation of Director Duties*, 21 Stetson L. Rev. 163, 168 (1991). The shareholders have exercised their prerogative to elect the board of directors to represent them. *Id.* at 190. As such, the board of directors owes its fiduciary duty to the group that elected it. *Id.*

132. See Nasuti & Rotwitt, *supra* note 129, at A-70; see also 15 Pa. Cons. Stat. Ann. § 1712(a) (West 1995) (describing generally the fiduciary relationship between directors and the corporation).

133. See Nasuti & Rotwitt, *supra* note 129, at A-70.

134. 42 Pa. Cons. Stat. Ann. § 8363 (Purdon's 1988) (repealed Dec. 19, P.L. 834, No. 198, § 306, imd. effective). Former §§ 8361 to 8367, which were added by Act 1986, Nov. 28, P.L. 1458, No. 145, § 1, related to standard of care, justifiable reliance, and personal liability of directors and prior to repeal were amended by Act 1988, June 30, P.L. 464, No. 79, § 6, and Act 1988, Dec. 21, P.L. 1444, No. 177, § 203. For subject matter of repealed § 8363, see 15 Pa. Cons. Stat. Ann. §§ 512, 516, 1712, 1716, 5712, 5716 (West 1995).

135. See *supra* note 131.

With the passage of Pennsylvania's 1990 anti-takeover legislation, it was acknowledged by the state legislature that the loss of jobs and corporate presence that accompanied post-hostile takeover liquidations was a grave enough threat to allow directors to, in some cases, subordinate the interests of equity investors to the interests of the corporation as a whole with respect to the community at large.<sup>136</sup> In light of this threat, Pennsylvania changed its approach to corporate fiduciary duties by providing that directors were no longer required to consider shareholders interests as "dominant or controlling."<sup>137</sup> Directors were to protect the best interests of the corporation which requires consideration of "shareholders, members, employees, suppliers, customers and creditors . . . and . . . communities."<sup>138</sup>

The provision specifically condoned the sacrifice of short-term shareholder interests in the name of long-term vision.<sup>139</sup> Many Pennsylvania Fortune 500 companies, including Conrail, strongly supported the legislation despite the possible adverse share price effects.<sup>140</sup> Other organizations, such as the AFL-CIO and the Pennsylvania Chamber of Business and Industry, also advocated for the statute's passage.<sup>141</sup>

Despite local support, the statute was met with substantial national opposition. Forty-two prominent business, law, and economics professors from across the country petitioned Governor Casey and legisla-

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136. See *supra* notes 96-115 and accompanying text regarding the debate surrounding the anti-takeover legislation. It is interesting to note the development of these non-shareholder concerns, considering that regulation of securities markets and control transactions was originally motivated on the federal level by a concern for shareholders. Daniel R. Fischel, *Efficient Capital Market Theory, the Market for Corporate Control, and the Regulation of Cash Tender Offers*, 57 Tex. L. Rev. 1, 24-25 (1978) (stating that shareholder protection was the sole goal of Congress). States had regulated the securities markets prior to federal involvement with "blue sky" laws that were similarly designed to protect the public from "speculative schemes which have no more basis than so many feet of 'blue sky.'" Cary, *supra* note 87, at 1598 (citing *Hall v. Geiger-Jones Co.*, 242 U.S. 539, 550 (1917)).

137. 15 Pa. Cons. Stat. Ann. §§ 512(a), 515(b), 1721 (West 1995). The language regarding "dominant or controlling" is directly from § 515(b). The effect of such a provision is to permit the board, when confronted with a takeover bid, to implement defense strategies even when doing so would not be in the best interests of shareholders, so long as some other constituency would be benefited. See Chandy, *supra* note 31.

138. 15 Pa. Cons. Stat. Ann. § 515(a)(1) (West 1995) (emphasis added).

139. *Id.* at § 515(a)(2). The legislature made it clear to Pennsylvania courts that it was repudiating the holdings of the Delaware Supreme Court in *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986). See *infra* note 190 and accompanying text. The *Revlon* holding required directors to act in the best interests of shareholders once a company was "in play" by maximizing shareholder value. *Id.*

140. Typically, companies choosing to be governed by anti-takeover statutes suffered a slight share price decrease. See Roberta Romano, *The Political Economy of Takeover Statutes*, 73 Va. L. Rev. 111, 136 (1987).

141. See Klein & Greenbaum, *supra* note 120, at 5.

tors, raising strenuous objections.<sup>142</sup> Furthermore, a number of pension fund managers expressed their displeasure with various provisions.<sup>143</sup> Richard C. Breeden, former chairman of the SEC, stated that the act "could do substantial damage to shareholders' well-established federal right to . . . replace a board of directors . . . [T]he risks of entrenched, self-perpetuating boards of directors would become much greater."<sup>144</sup> By allowing a corporate board to ignore a tender offer and justify the decision by claiming to serve a greater community interest, directors were increasingly able to insulate them from possible changes in corporate control.

The provision was motivated in part by the threatened takeover of a large Pennsylvania corporation, Armstrong World Industries, Inc., by a Canadian family.<sup>145</sup> It was feared that there would be job losses and plant closings resulting from the Armstrong takeover that would be detrimental to Pennsylvania's economy.<sup>146</sup> The potential takeover of Armstrong was similar to that of Conrail because thousands of jobs were at stake.<sup>147</sup> The two situations were different, however, because Armstrong was being threatened by a single hostile bidder.<sup>148</sup> Conrail was being courted by two bidders—one friendly and the other hostile.<sup>149</sup>

Debate on the floor of the state legislature was passionate and, although older provisions were already in operation,<sup>150</sup> the amendments prompted a review of the legislation in its entirety.<sup>151</sup> Senator Brightbill was convinced that the proposed legislation amounted to

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142. *Id.*; see also *supra* notes 117-122 and accompanying text (describing adverse effects of anti-takeover legislation such as declining share prices, chill on investment, and emasculation of shareholder power to effectuate change of corporate control by tendering into a lucrative bid).

143. Michael W. Armstrong, *At Least 67 Firms Buck Act 36*, Phila. Bus. J., July 30-August 5, 1990, at 1. The California Public Employees Retirement Fund indicated it might withdraw \$500 million of stock holdings in Pennsylvania companies. See Klein & Greenbaum, *supra* note 120, at 5.

144. Klein & Greenbaum, *supra* note 120, at 5.

145. McGurn & Spatola, *supra* note 42, at Pennsylvania-5. In fact, Senator Noah W. Wenger, who introduced the legislation, wrote to a colleague, "[t]he management team at Armstrong has urged me to enact this legislation as quickly as possible." *Id.*; see also Silberman, *supra* note 37, at 130.

146. Silberman, *supra* note 37, at 130; Klein & Greenbaum, *supra* note 120, at 5.

147. See *supra* note 146. The various proposed compromises would have resulted in significant regional shifts of business. Henry J. Holcomb, *Ports Plan Their Positions As They Await Conrail Fate*, Phila. Inquirer, Jan. 14, 1997, at C1. The new company would have altered the configuration of rail lines which would impact infrastructure development alongside the tracks, as well as ports. *Id.*

148. McGurn & Spatola, *supra* note 42, at Pennsylvania-5.

149. See *supra* notes 12-19 and accompanying text.

150. See *supra* note 134.

151. See *infra* notes 152-73.

the "most important issue that [the General Assembly would] deal with [that] year."<sup>152</sup>

Senator Brightbill argued that "the development of the fiduciary principles in the corporate field had historically been based upon the proposition that corporate managers owe their primary responsibilities to the owners of the corporation, the shareholders."<sup>153</sup> Although the Senator conceded that other constituencies should be considered, he felt strongly that shareholders should not be demoted to an equivalent or lesser consideration.<sup>154</sup> Broadening a director's responsibility to ambiguously-defined other constituencies makes it increasingly difficult for a board of directors to determine the proper course of action. The new law provided no standards for deciding between the often competing interests.<sup>155</sup> Additionally, Senator Brightbill feared that the statute's provisions were overbroad:

Once the courts get ahold of this provision, once they start plugging this fiduciary relationship into suits by suppliers, into suits under collective bargaining agreements, into suits by communities, once directors start getting sued by suppliers, employees, communities and everyone else, we are going to find out that we painted tonight with a broad brush.<sup>156</sup>

One legislator went even farther in criticizing the other constituencies concept. Senator Vincent Fumo, the then-ranking Democrat on the Senate Appropriations Committee, compared it to socialism and characterized it as the beginning of the end of the capitalist order.<sup>157</sup> His argument rested on the conception of stock ownership as a fundamental property right that must be protected by the government.<sup>158</sup> In addition to the historical and commonplace meaning of ownership, Senator Fumo pointed out that stockholders have a widespread expectation that their investment will be protected by the fiduciaries—that is, the board of directors.<sup>159</sup>

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152. S. 1310, 173d General Assembly, Sess. of 1989 (Pa. Dec. 12, 1989) at 1503 (remarks of Sen. Brightbill).

153. *Id.* (remarks of Sen. Brightbill, quoting David Ruder, former law professor and Chairman of the SEC).

154. *Id.* (remarks of Sen. Brightbill).

155. Although no state expressly provides standards for determining which interests are more important than others, there is support for the theory that these standards are self evident. *See, e.g.,* Wallman, *supra* note 131.

156. S. 1310-1747, 173d General Assembly, Sess. of 1989 (Pa. Dec. 12, 1989) at 1504 (remarks of Sen. Brightbill).

157. *Id.* (remarks of Sen. Fumo).

158. *Id.* at 1504-05. The implication was that because (1) investors "own" shares in the corporation with the expectation of profiting from those shares and (2) investors elect the board of directors, the board should serve the interests of the investors first. The other constituency provision allows the board to ignore, to some extent, shareholder interests which, in turn, is arguably an affront to the right afforded by the property ownership.

159. *Id.*

It was noted that "in many cases [workers] lost their jobs because of the same management [the legislature was] trying to protect . . . Government's responsibility is not to insulate the people in the boardroom who, by and large, have caused the problem."<sup>160</sup> Senator Fumo quoted an editorial in the Philadelphia Inquirer which stated:

This bill would hurt Pennsylvania's economy immediately by making the stock in Pennsylvania companies less attractive to investors. Big institutional investors in particular are uninterested in companies where the shareholders can't push management to improve. In the longer term it will hurt Pennsylvania companies by allowing inept managers to stay in control.<sup>161</sup>

Senator Fumo pointed out that the legislation would make it more difficult for young companies to raise equity capital.<sup>162</sup> He noted that "similar provisions in other legislatures . . . resulted in depressed values of the shares of the stock."<sup>163</sup>

Despite strong language opposing the amendments, evidence supporting the provision was equally forceful. For example, Michael Swartz, former chairman of a local Pennsylvania union, pleaded with the Senate to "give some very serious thought to the 'human cost' of takeover madness and why we must stop it here in our state."<sup>164</sup> In a letter to one senator he continued:

[H]ostile takeovers brought about the destruction of the Fruehauf Corporation . . . I saw the pain and grief on the faces of the men and women I worked with when the layoffs and then the shutdown hit. I know the same feelings must have ripped through the folks at Fruehauf . . . I've listed the names and hometowns of just some of the more than a thousand Pennsylvanians who lost jobs at Fruehauf. These folks and their kids, their homes, and their communities are really what this Bill is all about.<sup>165</sup>

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160. *Id.* at 1510.

161. S. 1310-2108, 173d General Assembly, Sess. of 1990 (Pa. April 23, 1990) at 1956 (remarks of Sen. Fumo quoting *A Shameful Bill: It Looks as if it's Too Late to Halt the 1990 Shareholder Rip-Off Act*, Phila. Inquirer, April, 21, 1990), at 8-A.

162. *Id.* at 1949 (remarks of Sen. Fumo) (arguing that companies are made less attractive to investors with the presence of state anti-takeover provisions).

163. *Id.*

164. S. 1310-1747, 173d General Assembly, Sess. of 1989 (Pa. Dec. 12, 1989) at 1506.

165. *Id.* (remarks of Sen. Lincoln). Fruehauf, a profitable Pennsylvania corporation employing 25,000, was the target of a hostile takeover by corporate raider Asher Edelman. *Id.* A "white knight" group rescued the company by engineering a leveraged buy-out and paying greenmail to Edelman in excess of \$100 million. *Id.* Greenmail is "[t]he practice of purchasing a large block of stock and then threatening a control fight with the hope and expectation that the target will purchase those shares at a significant premium over market." Solomon, *supra* note 31, at 1061. After the acquisition, Fruehauf was burdened with massive debt and began incurring significant losses related to the extraordinary debt payments. S. 1310-1747, 173d General Assembly, Sess. of 1989 (Pa. Dec. 12, 1989) at 1506. Fruehauf began selling off various units piecemeal and ceased all operations 3 years after paying off Edelman. *Id.*

Senator Wenger pointed out that giving paramount consideration to shareholders does not really clarify the applicable standards that a board must apply in fulfilling its fiduciary duty.<sup>166</sup> Short-term arbitrageurs have vastly different interests than long-term stockholders, and simply directing boards to act in the interests of "shareholders" is, therefore, ambiguous.

On the floor of the General Assembly during the debate about the provisions, Senator Wenger argued that a director's fiduciary responsibility should be to shareholders as well as other components of the "total corporation."<sup>167</sup> This concept of the "total corporation" encompasses a wide range of interests including, but not limited to, employees, bondholders, and local communities.<sup>168</sup> It was appropriate, in the Senator's view, to encourage those with the courage to "look at the big picture in the long run, the best interests of their corporation and what it does to the economy."<sup>169</sup> Senator Armstrong stated, "I think it is time we show the people, these corporate raiders who are coming to Pennsylvania that Pennsylvania is going to take a stand and we are going to watch out for our corporations, our employees and our communities."<sup>170</sup>

Ultimately, the sentiment of the Pennsylvania legislature and the philosophy that undermined the provisions were well summed up by Senator Armstrong:

Once again, to Sam Belzberg [the Canadian bidder for Armstrong] and Carl Icahn [a well-known corporate raider] and all the other corporate raiders, you do not have a friend in Pennsylvania when this bill passes. You really do not. We do not want you here. We do not think it is in the best interests of Pennsylvania to have you here.<sup>171</sup>

The House joined the spirited support for the bill with hopes that passing such an anti-takeover measure would send a loud and clear message to those "who would make . . . Pennsylvania corporations simple, quick-profit chop shops . . . that is, Pennsylvania is no longer your playground."<sup>172</sup>

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166. S. 1310-1747, 173d General Assembly, Sess. of 1989 (Pa. Dec. 12, 1989) at 1507 (remarks of Sen. Wenger).

167. *Id.*

168. See Wallman, *supra* note 131, at 179.

169. See *supra* note 166, at 1507.

170. S. 1310-1747, 173d General Assembly, Sess. of 1989 (Pa. Dec. 12, 1989) at 1509 (remarks of Sen. Armstrong).

171. S. 1310-2108, 173d General Assembly, Sess. of 1990 (Pa. April 23, 1990) at 1951 (remarks of Sen. Armstrong).

172. H. 28, 173d General Assembly, Sess. of 1990 (Pa. April 24, 1990) at 778 (remarks of Rep. F. Taylor discussing S. 1310, PN 2108).

The bill was passed in both the Pennsylvania House and Senate by overwhelming majorities.<sup>173</sup> Although the provisions dissuaded the Armstrong takeover,<sup>174</sup> its impact on future mergers and acquisitions was highly speculative. The Conrail merger fight marked the law's first major test.<sup>175</sup>

### B. *The Pennsylvania Statute's Effect on the Merger*

Negotiations concerning Conrail had begun in earnest in early October, 1996, when CSX agreed to Conrail's merger agreement terms.<sup>176</sup> They included (1) putting the combined company's headquarters in Philadelphia, (2) maintaining most of Conrail's existing rail routes, (3) providing LeVan the opportunity to succeed Snow within two years, and (4) offering LeVan a salary increase.<sup>177</sup>

#### 1. Fair Price Provision

On October 15, 1996, Conrail and CSX publicly announced their merger agreement, which was valued at approximately \$8.4 billion.<sup>178</sup> The two-tier tender offer proposal offered \$92.50 per share for 40% of Conrail's stock.<sup>179</sup> The remaining 60% would be exchanged for CSX stock.<sup>180</sup>

This type of two-tier front-loaded offer was exactly what the fair price provision was intended to prevent.<sup>181</sup> Once the bidder, in this case CSX, acquired 20% of the voting rights, Pennsylvania law prevented it from offering a lower value for the back-end shares.<sup>182</sup> CSX, although considered a friendly bidder, was being thwarted by Pennsylvania law. Although the law did not seem intended to prevent a company from being taken over by a friendly bidder, that was its effect at this stage of the negotiations.<sup>183</sup>

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173. The House of Representatives approved the act by a vote of 183-17. *Id.* at 779-80. The Senate approved the act 43-6. McGurn & Spatola, *supra* note 42, at Pennsylvania-6.

174. See Tascarella, *supra* note 111, at 22.

175. See Cassel, *supra* note 23, at C1.

176. Steve Lipin, et al., *Norfolk Southern Bids \$9.1 Billion for Conrail*, Wall St. J., Oct. 24, 1996, at A3; Charles Slack, *On A Collision Course CSX Picks Up Steam in Fight For Conrail*, Richmond Times-Dispatch, Dec. 2, 1996, at D14.

177. See Machalaba & Mathews, *supra* note 16, at 1.

178. *CSX and Conrail to Combine in Pro-Competitive, Strategic Merger*, PR NEWswire, Oct. 15, 1996, available in WESTLAW, PRNEWS Database.

179. *Id.*

180. *Id.*

181. See *supra* Part I.B.3.

182. See *supra* Part II.A.1.

183. This unintended outcome was a result of the vague definition of "Interested Shareholder" in the statute. See *Poison Pills*, *supra* note 37, at 45. An interested shareholder is defined as including "the shareholder who is a party to the transaction or who is treated differently from other shareholders and any person, or group of persons, that is acting . . . with the interested shareholder." 15 Pa. Cons. Stat. Ann.



By October 23, 1996, Conrail stock had climbed to over \$95 per share from offers in the \$70 range one month earlier.<sup>184</sup> The following day, Norfolk launched a competing \$100 per share all-cash bid.<sup>185</sup> Conrail's directors agreed to review the offer, but reiterated to shareholders that the merger with CSX was in their best interests.<sup>186</sup> By November 5, 1996, Conrail had tendered 56,634 shares to CSX.<sup>187</sup> This was a mere fraction of the total<sup>188</sup> and demonstrated the shareholders' displeasure with the lower bid. In response, on November 6, 1996, CSX raised the cash portion of its offer to \$110 per share.<sup>189</sup> Although still two-tiered, the offer now promised more than Norfolk on the front end. Conrail also agreed to continue to ignore other suitors, including Norfolk, who were willing to offer a higher bid.<sup>190</sup>

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§ 2538(d) (West 1995). This could apply to a hostile bidder or, as in this instance, a friendly bidder.

184. *CSX Net Falls 7.2% Because of Purchase of Chunk of Conrail*, Wall St. J., Oct. 24, 1997, at C4.

185. *Norfolk Southern Commences Tender Offer to Acquire Conrail Shares for \$100 Per Share*, PR NEWswire, Oct. 24, 1996, available in WESTLAW, PRNEWS Database.

186. *Conrail Advises Shareholders To Await Board Response To Norfolk Southern Unsolicited Offer Before Taking Any Action*, PR NEWswire, Oct. 23, 1996, available in WESTLAW, PRNEWS Database.

187. *CSX and Conrail Amend Merger Agreement*, PR NEWswire, Nov. 6, 1996, available in WESTLAW, PRNEWS Database.

188. There were approximately 90 million shares of Conrail voting shares outstanding. See *id.*; see also Form SCD 13D A00, Conrail Exhibit 99 - OFFER TO PURCHASE FOR CASH ALL OUTSTANDING SHARES OF COMMON STOCK AND SERIES A ESOP CONVERTIBLE JUNIOR PREFERRED STOCK (INCLUDING, IN EACH CASE, THE ASSOCIATED COMMON STOCK PURCHASE RIGHTS) OF CONRAIL INC. AT \$115 NET PER SHARE BY ATLANTIC ACQUISITION CORPORATION, A WHOLLY OWNED SUBSIDIARY OF NORFOLK SOUTHERN CORPORATION. (EdgarPlus Feb. 13, 1997) [hereinafter "Exhibit 99"], at 3.

189. *CSX and Conrail Amend Merger Agreement*, Nov. 6, 1996, *supra* note 187.

190. There were two important factors that contributed to this stance. First, Conrail had agreed to a no-shop provision in the original merger agreement with CSX that prevented Conrail directors from participating in proposals from other suitors until April 15, 1997. See Garrity & Morton, *supra* note 4, at 680 (citing § 4.2 of the Merger Agreement). Second, Pennsylvania's other constituency provision gave Conrail's board the leeway to continue disregarding Norfolk's higher bid. See *supra* Part I.B.2.

Delaware courts have held that shareholders must be given primary consideration in a takeover context. See *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986) (holding that once it becomes clear that a corporation will be sold or broken up, the board has a duty to conduct an auction or by some other means seek to obtain the highest price for shareholders); and *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985) (holding that defensive tactics used by directors must be executed only if the directors have a reasonable ground for believing that a danger to corporate policy existed and that the response was reasonable in relation to the threat posed). Pennsylvania, however, has no such law. See Dennis J. Block & Jonathan M. Hoff, *Conrail/CSX: Pennsylvania Law on Different Track than Delaware*, N.Y. L.J., Feb. 27, 1997, at 1. In fact, the Pennsylvania legislature modified the existing anti-takeover statute in 1990 to clarify to Pennsylvania courts that it repudiated the *Revlon* decision. See Nasuti & Rotwitt, *supra* note 129, at A-70.

On November 8, 1996, Norfolk responded by raising its offer to \$110.<sup>191</sup> This offer was \$17 or 18% higher than the blended two-tiered CSX scheme. Further, CSX had yet to overcome the fair price provision, which required shareholders to opt out of the provision if they were interested in pursuing CSX's offer.<sup>192</sup>

Conrail shareholders were allowed to opt out<sup>193</sup> of the provision and a shareholder meeting was called by the board to vote on opting out.<sup>194</sup> A corporation could opt out at any time by amending its articles of incorporation.<sup>195</sup> Many Pennsylvania companies had already chosen to opt out of the statute.<sup>196</sup> Ironically, in most instances, they were the same companies the Act was designed to protect.<sup>197</sup>

In the meantime, CSX immediately offered to buy 19.9% of Conrail stock, which amounted to approximately 17.9 million shares.<sup>198</sup> This allowed them to begin acquiring shares without triggering the fair price provision and rendering its back-end stock offer illegal.<sup>199</sup> At the Conrail shareholder meeting on January 17, 1997, shareholders refused to opt out of the fair price provision.<sup>200</sup> A "yes" vote would have allowed CSX to purchase additional shares of Conrail, increase its holdings to 40%, and effectively seal the merger. Fifty-three percent of all those voting, however, voted against opting out.<sup>201</sup> Share-

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191. *Norfolk Southern Increases Offer for Conrail*, PR NEWSWIRE, Nov. 8, 1996, available in WESTLAW, PRNEWS Database.

192. See *supra* notes 119-120.

193. See *supra* note 120.

194. Greg Edwards, *CSX, Conrail Defend Deal*, Roanoke Times & World News, Dec. 12, 1996, at B10; Harrisburg Patriot, *CSX Moves to Buy More Conrail Stock*, Associated Press, Dec. 7, 1996, at A8.

195. S. 1310-2108, 173d. General Assembly, Sess. of 1989 (Pa. Apr. 23, 1990) at 1953 (remarks of Sen. Fisher). Conrail opted out of two provisions that have not been discussed: the disgorgement (15 Pa. Cons. Stat. Ann. § 2572 (West 1995)) and control-share acquisition provisions (15 Pa. Cons. Stat. Ann. Ch. 25, Subch. G); Justin P. Klein & Jeffrey P. Greenbaum, *Takeover Law: Many Pennsylvania Companies Opt Out*, 15 Nat'l L. J., Sept. 10, 1990, at 15; see also William H. Clark, Jr., *Corporations Must Decide on Anti-Takeover Act Opinions*, 13 Pa. L.J. Rep. 25 (June 25, 1990), at 4 (discussing the decision corporations were faced with regarding opting out after the Pennsylvania law was enacted).

196. See *supra* note 120 and accompanying text.

197. See Klein & Greenbaum, *supra* note 120, at 5. Studies have shown that upon opting out of the major Pennsylvania anti-takeover provisions, companies experienced a significant positive increase in share price on average. See McGurn & Spatola, *supra* note 42, at Pennsylvania-9. However, companies that opted out of the control share provision, but not the other constituency provision, experienced no significant change in share price. *Id.*

198. *CSX and Conrail to Combine in Pro-Competitive, Strategic Merger*, PR NEWSWIRE, Oct. 15, 1996, available in WESTLAW, PRNEWS Database.

199. The fair price provision does not apply to a tender offeror until the offeror acquires a control amount of stock, which in Pennsylvania is 20%. See *supra* Part II.A.1.

200. *Conrail Shareholders Overwhelmingly Vote Against Opt Out*, PR NEWSWIRE, Jan. 17, 1997, available in WESTLAW, PRNEWS Database.

201. Rip Watson, *Conrail, Norfolk Soften Stance in Wake of Merger Vote*, J. of Comm., Jan. 22, 1997.

holders unaffiliated with Conrail or CSX voted overwhelmingly, by a margin of 92%, against the proposed opt out.<sup>202</sup> Supporting the opt out would have indicated either that the shareholders supported the coercive two-tier scheme, or, at least, that they supported the CSX bid for the corporation despite a lack of enthusiasm for the offer price.

David Goode, CEO of Norfolk, felt the shareholder vote was the key to Norfolk's victory in overcoming Conrail's resistance to merge with Norfolk.<sup>203</sup> He saw the vote against the opt out as a "resounding vote for Norfolk."<sup>204</sup> Although Conrail shareholders seemed to be supportive of Norfolk's bid in any case, Norfolk's last minute offer to purchase 9.9% of the stock at \$115 if the shareholders voted against the opt out invariably sweetened the pot.<sup>205</sup>

The fair price provision effectively protected the shareholders from being forced to tender into a two-tiered offer. Therefore, CSX was compelled to offer an all-cash deal, and, in the face of increasing Norfolk bids, CSX finally offered shareholders \$115 per share.<sup>206</sup> As intended, the fair price provision guaranteed the shareholders a better deal. It frustrated LeVan's goals, however, of effectuating a smooth merger with CSX. The fair price provision gave Norfolk the opportunity to offer a counter-bid that surpassed CSX. In light of the escalating bids, CSX was ultimately forced to negotiate with Norfolk.<sup>207</sup> LeVan was prepared to sacrifice Conrail's independence to merge with CSX, but the fair price provision prevented him from sacrificing shareholder interests to do it.

## 2. Other Constituencies

At the Conrail shareholder meeting, Joseph Folk, a 20-year Conrail veteran, voiced the same concern that helped prompt the Pennsylvania legislature to pass the anti-takeover provisions—short-term shareholders who cared little about the company and its future had more influence on the outcome of the merger than employees who had worked with the company for decades.<sup>208</sup> He spoke out against the arbitrageurs, who overwhelmingly voted against the opt out provision and asked why "stock traders who have owned [Conrail] shares

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202. Christopher Dinsmore, *Conrail Voters Reject CSX Bid*, *Virginian-Pilot & Ledger-Star*, Jan. 18, 1997, at A1.

203. Justin Martin & David Goode, *Surviving A Head-On Collision*, *Fortune*, April 14, 1997, at 159, 160.

204. *Id.*

205. Norfolk offered to buy only 9.9% of the stock because they were constrained by Conrail's poison pill defense scheme. *See infra* Part II.C.1. & notes 242-47. Poison pill schemes are a defensive tactic which make a hostile bid more difficult by diluting the value of a company's stock if a large percentage of it is acquired by a hostile bidder. *Id.*

206. *See supra* note 200.

207. Machalaba & Mathews, *supra* note 16.

208. Andrew Cassel, *Conrail Bets Its Future On Arbitrageurs*, *Philadelphia Inquirer*, Jan. 26, 1997, at D1.

for one or two months" should have more influence than workers and investors who have been with the company since its inception.<sup>209</sup>

The first two terms of LeVan's original agreement<sup>210</sup> with Snow, putting the combined company's headquarters in Philadelphia and maintaining most of Conrail's existing rail routes, suggest that LeVan was attempting to protect other constituencies. Conrail's presence in Philadelphia affected the city's economy, and the existing rail routes provided economic growth for the adjacent areas.<sup>211</sup> CSX's commitment to continue Conrail's existing operations should have quelled the typical takeover concerns of job loss and economic withdrawals.<sup>212</sup> On October 15, 1996, Snow announced that "[t]his dynamic combination is a 'win-win' transaction for the shareholders . . . our customers and the communities we both serve."<sup>213</sup> The rhetoric was not limited to the once all-important shareholders.

When Norfolk initially launched its competing all cash bid for \$100 per share,<sup>214</sup> the Conrail board of directors advised shareholders to ignore the Norfolk bid because the "[b]oard had already carefully considered the relative merits of a merger with Norfolk [and] had unanimously determined that a merger with CSX was in the best interests of Conrail *and its constituencies*."<sup>215</sup> By relying on the other constituencies provision, Pennsylvania's tough anti-takeover law provided Conrail's management with enough leeway to continue to hold Norfolk at bay. Conrail's board invoked this provision to justify its disregard for Norfolk's higher-valued bid that benefited the short-term interest of shareholders.

It is unclear how Conrail balanced the interests of shareholders with those of other constituencies. Shareholders were presented with a superior offer from Norfolk, yet the Conrail board seemed convinced that the best long-term interests of the corporation rested with CSX.<sup>216</sup> Despite the statutory grant of authority to hold the interests of other constituencies in the highest regard,<sup>217</sup> the board was still forced to go to the shareholders for support. As one observer put it,

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209. *Id.*

210. See *supra* notes 176-77 and accompanying text.

211. Holcomb, *supra* note 147, at C1.

212. See *supra* note 103 and accompanying text.

213. *CSX and Conrail to Combine in Pro-Competitive, Strategic Merger*, PR NEWswire, Oct. 15, 1996, available in WESTLAW, PRNEWS Database.

214. *Norfolk Southern Commences Tender Offer to Acquire Conrail Shares for \$100 Per Share*, PR NEWswire, Oct. 24, 1996, available in WESTLAW, PRNEWS Database.

215. *Conrail Advises Shareholders to Await Board Response to Norfolk Southern Unsolicited Offer Before Taking Any Action*, PR NEWswire, Oct. 23, 1996, available in WESTLAW, PRNEWS Database (emphasis added).

216. *Id.*

217. See *supra* Part II.A.2.

"[o]nly one constituency [shareholders] ha[d] a vote."<sup>218</sup> This situation illustrates the conflict that may arise between the Pennsylvania provisions in this type of unanticipated two-bidder situation. The other constituencies provision was intended to give management the ability to ignore unfriendly bids if it felt the future of the company was at stake.<sup>219</sup> The legislative debate, however, does not indicate that the legislature contemplated this type of two-bidder situation.<sup>220</sup> Regardless, Conrail management was attempting to use the provision to favor one bidder over another and, in the process, deny shareholders the highest price for their stock. The problem for Conrail's board was that, in this situation, the other constituencies provision had no teeth. If the statute had force, then Conrail should have been able to fend off Norfolk's advances. Instead, the fair price provision rendered the other constituencies provision meaningless by allowing shareholders to unilaterally prevent CSX's bid.<sup>221</sup> Shareholders, seemingly at odds with management's concern for other constituencies,<sup>222</sup> were still able to accept the Norfolk bid.<sup>223</sup> The unenthusiastic early November shareholder response to CSX's offer suggested that the value of the bids was primarily influencing the outcome, not concern for other constituencies.

On November 13, 1996, Norfolk seized on the ambiguity in the statute and accused Conrail of "subvert[ing] the intent of state law and coerc[ing] Conrail shareholders into accepting an inadequate offer for their shares."<sup>224</sup> Although the Pennsylvania law was intended to prevent unfriendly takeovers, many of the provisions were ultimately aimed at protecting shareholders.<sup>225</sup> Both Norfolk and CSX seemed justified in claiming the law was meant to favor them. Presumably, Norfolk could invoke the provisions aimed at shareholder protection,<sup>226</sup> while CSX could rely on the anti-takeover provisions.<sup>227</sup> In either case, it was unclear whether Conrail and its other constituencies were truly in better hands with CSX. CSX was headquartered out-of-state and it anticipated layoffs and down-sizing as a result of the merger.<sup>228</sup> From the standpoint of other constituencies in Pennsylvania, it was a toss-up between the two bidders.

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218. Cassel, *supra* note 23, at C2 (quoting Henry Bryans, a lawyer with Drinker, Biddle & Reath in Philadelphia).

219. *See supra* Part II.A.2.

220. *Id.*

221. *See supra* Part II.B.1.

222. *See infra* note 236 and accompanying advertisement.

223. *See supra* notes 25 & 203-05 and accompanying text.

224. *Norfolk Southern Says Conrail Directors Continue to Ignore Fiduciary Duty*, PR NEWSWIRE, Nov. 13, 1996, available in WESTLAW, PRNEWS Database.

225. *See supra* Part I.B.

226. *See supra* Part II.A.1.

227. *See supra* Part II.A.2.

228. *CSX and Conrail to Combine in Pro-Competitive, Strategic Merger*, PR NEWSWIRE, Oct. 15, 1996, available in WESTLAW, PRNEWS Database.

Both CSX and Norfolk began a media blitz in January 1997, each hoping to persuade the public that they were more responsive to Conrail's other constituencies.<sup>229</sup> It is noteworthy that all of the advertisements were either addressed directly to shareholders, or implicitly aimed toward them.<sup>230</sup>

In a January 28, 1997, letter to shareholders, LeVan wrote, "[T]he Conrail Board continues to believe that a sale to Norfolk is not in the best interests of Conrail."<sup>231</sup> Despite anticipated job losses as a result of the consolidation, the chairmen of both CSX and Norfolk continued to articulate their concern for the broad-based constituencies affected by the transaction.<sup>232</sup> Additionally, shareholder interests were

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229. For the next several weeks, in anticipation of the Shareholder Meeting, Norfolk and Conrail (on behalf of CSX) ran competing advertisements touting their superior value to all constituencies. See, e.g., Wall St. J., Jan. 8, 1997, at C19, stating:

PROTECT YOUR INTERESTS  
SUPPORT NORFOLK SOUTHERN'S  
SUPERIOR \$115 PER SHARE  
ALL CASH OFFER.

*Join those who are demanding that the Conrail Board secure the superior benefits of the Norfolk Southern offer for all constituencies.*

GREATER VALUE FOR SHAREHOLDERS

Norfolk Southern's \$115 all-cash, all-shares offer . . . is worth 18% more than CSX's current deal. And it does not subject you to the substantial equity risk presented by receiving part of your payment in CSX stock. . .

BETTER FOR CONRAIL EMPLOYEES

A merger between CSX and Conrail would eliminate competitive rail service in 64 cities, and . . . these could add up to lost jobs. A Norfolk Southern/Conrail system would have substantially less overlap. . .

A MORE COMPETITIVE ENVIRONMENT FOR SHIPPERS

A CSX/Conrail combination would eliminate competitive service in major markets. . . A Norfolk Southern/Conrail combination will provide balanced competition by creating a strong rail alternative to compete with CSX.

A STRONGER COMMITMENT TO THE ECONOMIES OF PHILADELPHIA AND PENNSYLVANIA

Norfolk Southern is committed to maintaining a major operating presence in Philadelphia. . . and will seek to promote employment [there].

See also Wall St. J., Jan. 13, 1997, at C9 (advocating that the CSX-Conrail merger had "substantial upside potential"); Wall St. J., Jan. 13, 1997, at C15 (characterizing the CSX offer as "inferior" to Norfolk's and suggesting that shareholders are being tricked into accepting an inadequate bid); Wall St. J., Jan. 15, 1997, at C11 (comparing Norfolk's offer to that of CSX); Wall St. J., Jan. 15, 1997, at C17 (encouraging shareholders to support the CSX bid).

230. See, e.g., Wall St. J., Jan. 8, 1997, at C19, *supra* note 229.

231. See *Conrail Board Fully Committed to CSX Merger* (visited Jan. 28, 1997) <<http://www.conrail.com/news/nr970128.htm>> (citing contents of LeVan's open letter).

232. See e.g., *CSX and Conrail to Combine in Pro-Competitive, Strategic Merger*, PR NEWswire, Oct. 15, 1996, available in WESTLAW, PRNEWS Database.



despite the other constituencies provision, Norfolk continued to plead to shareholders' short-term interests. The Conrail Board's ambivalent reaction to Norfolk's superior offer directly resulted from the other constituencies provision, which justified such a posture. Nevertheless, an analyst with a large investment bank pointed out that "[f]or [Conrail] to object to shareholders tendering into what is demonstrably a higher offer could run them into problems."<sup>237</sup> The Conrail board didn't have to worry about legal problems—for example, breach of fiduciary duty—because it was protected by the other constituencies provision.<sup>238</sup> Yet, its disregard for short-term shareholder interests provided Norfolk with an opportunity to attack CSX's offer. It is probable that, had CSX agreed to an all cash offer from the beginning, Norfolk would have been unable to mount such an effective campaign. In such an event, the fair price provision would not have come into play. Conrail would not have had to opt out of the provision and shareholders would have been faced with only one real suitor. Norfolk could still have made a hostile bid, but the other constituencies statute would give Conrail's board the justification to ignore the offer. Although Norfolk could have continued to pursue a hostile offer, the lack of Conrail board approval would make the process more difficult. It seems that Pennsylvania law would not have interfered with the merger had CSX avoided a two-tiered scheme.

Norfolk had made a tender offer for 9.9%—approximately 8.2 million shares—in mid-January for \$115 per share and, by early February, 66.8 million shares were tendered for the \$115 per share bid.<sup>239</sup> Shareholders seemed to appreciate the higher offer and reacted favorably. Apparently, the long-term opportunities of the Conrail-CSX merger did not seem as lucrative as cashing out for Norfolk's higher offer.

### C. *Other Defensive Measures Taken by Conrail and CSX*

Regardless of whether a company decides to be covered by a state anti-takeover statute, it may adopt a variety of additional anti-takeover devices often referred to as "shark repellents."<sup>240</sup> So long as these charter and by-law provisions and other defenses do not conflict with state statutes, they work in tandem with the state anti-takeover provisions.<sup>241</sup>

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237. Lynette Khalfani, *Revised Norfolk Offer Draws Unusual Response from Conrail*, Dow Jones News Service, Jan. 28, 1997, available in WESTLAW, DJNSPlus Database (quoting James Higgins, an analyst with Donaldson, Lufkin & Jenrette Securities, Inc.).

238. See *supra* Part II.A.2.

239. *Norfolk Southern Completes Tender Offer for 9.9% of Conrail Shares*, PR NEWswire, Feb. 5, 1997, available in WESTLAW, PRNEWS Database.

240. See *Poison Pills*, *supra* note 37, at 83.

241. *Id.*



## 1. Poison Pills

Although not part of the anti-takeover provisions passed in 1990, Pennsylvania law does allow the use of "poison pills" to deter hostile bidders.<sup>242</sup> "Poison pills," which exist in a variety of forms, are a type of defensive tactic that make a hostile bid more difficult.<sup>243</sup> One type involves the distribution to existing shareholders of a new security, a "right," that is triggered when the bidder acquires a certain amount of stock in the target.<sup>244</sup> At that time, shareholders of the target are entitled to buy shares of the target that have not yet been sold, at a substantial discount, thereby diluting the value of the target shares held by the bidder.<sup>245</sup>

Pennsylvania's applicable statute specifically authorizes a security that "limits any [shareholder] . . . from exercising, converting, transferring or receiving the shares."<sup>246</sup> This gives the board the ability to prevent a large shareholder from exercising the voting power of their shares. Further, authorization is granted for provisions "concerning rights or adjustments in the event of . . . merger . . . or other fundamental changes."<sup>247</sup>

Several years earlier, on July 19, 1989, the Conrail board declared a dividend distribution of one right for each share of common stock.<sup>248</sup> The right entitled the holder to purchase one common share at an exercise price of \$205.<sup>249</sup> The rights could be exercised ten business days after the acquisition by a person or group of 10% or more of the outstanding shares.<sup>250</sup> Prior to that time, the board was authorized to redeem the rights for \$.005 per right.<sup>251</sup> Pursuant to the merger agree-

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242. 15 Pa. Cons. Stat. Ann. § 2513(a) (West 1995).

243. See Klein & Coffee, *supra* note 14, at 186; see e.g., *Moran v. Household Int'l, Inc.*, 490 A.2d 1059 (Del. Ch.), *aff'd* 500 A.2d 1346 (Del. 1985) (upholding a type of poison pill). There is no standard form of poison pill. Solomon, *supra* note 30, at 1137. Commonly, it is a Right to purchase a share of stock, distributed as a dividend to shareholders, at any time within a specified period. *Id.* Generally, the Board may redeem the Rights, if it chooses, until a certain designated date. *Id.* at 1063. The exercise price of the Right is the estimated value of the stock in the future, which means it has little present value. *Id.* at 1137. The key is a "flip" provision that is triggered when an outsider purchases a certain percentage of stock. *Id.* At that point, the Rights become separately tradable and no longer redeemable. *Id.* If the outsider attains control, and then causes the issuer to merge with itself, the Rights entitle the holder to acquire shares of the acquiring corporation at a significant discount. *Id.*

244. See Klein & Coffee, *supra* note 14, at 185. The pill described in the accompanying text is referred to as a "flip-in" pill. *Id.*

245. *Id.* at 187.

246. 15 Pa. Cons. Stat. Ann. § 2513(a) (West 1995).

247. 15 Pa. Cons. Stat. Ann. § 1525(b)(3) (West 1995).

248. See Exhibit 99, *supra* note 188, at 4. On Oct. 2, 1995, one right was distributed with respect to each outstanding Employee Stock Option Plan ("ESOP") share. *Id.*

249. *Id.*

250. *Id.* at 4-5.

251. *Id.* at 5.

ment between Conrail and CSX, the Conrail board made the rights inapplicable to CSX offers.<sup>252</sup>

After Norfolk increased its bid to \$115 per share on December 20, 1996, Conrail recommended that shareholders reject it.<sup>253</sup> On January 13, 1997, Norfolk announced it would buy 9.9% or 8.2 million Conrail shares<sup>254</sup> for \$115 per share, contingent on the defeat of the opt out of the fair value provision.<sup>255</sup> This was the maximum amount Norfolk could purchase without triggering the pill.<sup>256</sup> The pill was never executed because Norfolk never directly acquired more than 9.9% of the stock.<sup>257</sup>

Conrail also agreed to a no-shop clause<sup>258</sup> with CSX that forbade Conrail from engaging in negotiations with other suitors.<sup>259</sup> Specifically, Conrail could negotiate with other bidders only if: (1) the fiduciary duties of the board required such negotiations; and (2) those negotiations took place within a strict time frame.<sup>260</sup> The board of directors was entitled to ignore rival offers, regardless of their value.<sup>261</sup>

## 2. The Legality of Conrail's Defensive Measures

On October 23, 1996, Norfolk sought a preliminary injunction in federal court to block Conrail from executing the merger with CSX, prevent Conrail's poison pill scheme, and enjoin the shareholder vote that would allow Conrail to opt out of the fair price provision.<sup>262</sup> Conrail's attempt to merge with CSX and disregard Norfolk was argued to be "without regard for the best interests of its shareholders or other

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252. *Id.* at 2. Pennsylvania law allowed the board to discriminate against Norfolk, in this manner. See *supra* note 246.

253. *Conrail Rejects Norfolk Southern's Revised Hostile Offer*, PR NEWswire, Dec. 20, 1996, available in WESTLAW, PRNEWS Database.

254. See Exhibit 99, *supra* note 188, at 2; see also *Norfolk Southern to Buy 9.9% of Conrail if Shareholders Vote Against 'Opt Out' Proposal*, PR NEWswire, Jan. 13, 1997, available in WESTLAW, PRNEWS Database (discussing Norfolk's offer to shareholders).

255. See Exhibit 99, *supra* note 188, at 2.

256. See *supra* note 248-49.

257. See Garrity & Morton, *supra* note 4, at 711.

258. For a thorough discussion of the lock-up provisions of the original Conrail/CSX merger agreement, see Garrity & Morton, *supra* note 4.

259. See Block & Hoff, *supra* note 190, at 1.

260. *Id.*

261. Although the business judgment rule generally insulates directors of liability from ignoring rival bids, the no-shop provision contractually prevents directors from doing so. Conrail had also agreed to a \$300 million breakup fee payable to CSX if the agreement between the two companies fell through. See Ron Carter, *Conrail Saga Continues This Week in Courtroom*, The Columbus Dispatch, Feb. 24, 1997, at 3.

262. Complaint P4, Norfolk Southern Corp. (C.A. No. 96-CV-7167) (E.D.Pa. filed October 23, 1996)[hereinafter Complaint]; *Norfolk Southern Asks Court to Block Conrail 'Poison Pill'*, PR NEWswire, Nov. 1, 1996, available in WESTLAW, PRNEWS Database.

constituencies.”<sup>263</sup> Norfolk alleged, among other things, that Conrail breached its fiduciary duty to the shareholders as evidenced by the coercive nature of the proposed CSX transaction, the poison pill, the lock-up provision and various other parts of the merger agreement.<sup>264</sup> The court denied all the motions.<sup>265</sup> The court held that the Conrail board had nearly unlimited discretion to undertake any action it deemed appropriate.<sup>266</sup> Further, the court suggested that although Delaware law, for example, demands primary consideration for shareholders’ interests, this approach was “myopic” and misguided because it ignored the important long-term interests of a corporation.<sup>267</sup> Ruling on a later injunctive motion by Norfolk,<sup>268</sup> Judge VanArtsdalen characterized the Delaware approach<sup>269</sup> as “replac[ing] the discretion of [a] corporate board of directors who hopefully are sophisticated practical business managers” with the less reliable business judgments of judges.<sup>270</sup> Although this logic is compelling in some circumstances, the Pennsylvania court seemed to discount the potential conflict of interest that often exists between directors and shareholders.<sup>271</sup>

The predominant standard of judicial review of the actions taken by a target company’s board to defend their control was articulated by the Delaware Supreme Court in *Unocal v. Mesa Petroleum Co.*<sup>272</sup> The court noted the “omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders.”<sup>273</sup> This analysis, however, was geared toward a single bidder, hostile tender offer.<sup>274</sup> *Unocal*’s heightened standard of re-

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263. *Norfolk Southern Asks Court to Block Conrail ‘Poison Pill,’* PR NEWSWIRE, Nov. 1, 1996, available in WESTLAW, PRNEWS Database.

264. See Exhibit 99, *supra* note 188, at 47.

265. *Norfolk Southern Corp. v. Conrail Inc.*, C.A. No. 96-CV-7167 and 96-7350, 1997 U.S. Dist. LEXIS 978 (E.D. Pa. Nov. 19, 1996) (Bench Ruling of J. VanArtsdalen) (order denying preliminary injunction).

266. *Id.*; see Block & Hoff, *supra* note 190, at 1.

267. *Norfolk Southern Corp.*, 1997 U.S. Dist. LEXIS 978.

268. *Norfolk Southern Corp.*, 1997 U.S. Dist. LEXIS 978.

269. See *supra* note 190.

270. *Norfolk Southern Corp.*, 1997 U.S. Dist. LEXIS 978. Courts rarely disturb a decision reached by a board, or impose liability on board members, unless a history of self-dealing, conflict of interest, or illegality is present. See Klein & Coffee, *supra* note 14, at 126. This principle is known as the “business judgment rule” and it presumes that directors’ decisions will not be second-guessed by the courts except in extreme circumstances. See Block & Hoff, *supra* note 190.

271. A bidder is expected to change at least some of the target company’s operations if it successfully acquires control. See Cox, *supra* note 38, at 23.23-23.24. In a contest for corporate control, directors may act to improperly entrench themselves as opposed to protecting the best interests of the corporation and its shareholders. See Block & Hoff, *supra* note 190, at 1. In the Conrail example, it didn’t appear the interests of the board and the shareholders were coextensive.

272. 493 A.2d 946 (Del. 1985).

273. *Id.* at 954.

274. *Id.* at 953-55.

view for board conduct in a takeover context did not contemplate a two-bidder situation.

The Delaware court addressed this shortcoming of the *Unocal* decision in *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*<sup>275</sup> In this case, two bidders were competing for control over Revlon.<sup>276</sup> One bidder, Forstmann Little & Company, was a "white knight"<sup>277</sup> and the other bidder, Pantry Pride, Inc., was a hostile bidder.<sup>278</sup> The court held that when a board of directors has determined that the sale of a corporation is inevitable, the board's fiduciary duty requires it to maximize shareholder wealth and "auction" the company.<sup>279</sup> *Revlon*, by contemplating a two-bidder situation, is a qualification of *Unocal*.<sup>280</sup> It does not prohibit defensive measures; rather, it sets additional standards for the target board to act in its shareholder's best interest.<sup>281</sup>

The Delaware approach stands in stark contrast to Pennsylvania, where fiduciary duties are not heightened or subject to any higher burden of proof with respect to a potential or proposed acquisition or control of the corporation.<sup>282</sup> The Pennsylvania provisions specifically rejected both the *Unocal* standard of heightened scrutiny, as well as the *Revlon* auction duty, applied by Delaware Courts.<sup>283</sup> In fact, the Pennsylvania legislature went so far as to reverse the Delaware presumption and, instead, presume that the actions of a board in a takeover context are in the corporation's best interest.<sup>284</sup>

Although the Pennsylvania court criticized the disregard Delaware showed for long-term corporate interests in *Paramount Communications, Inc. v. Time Inc.*,<sup>285</sup> the Delaware Supreme Court embraced directors who took action to protect the long-term interests of a company.<sup>286</sup> In this respect, although the Pennsylvania court didn't refer to Delaware's *Paramount* holding, it followed the logic of the

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275. 506 A.2d 173 (Del. 1986).

276. *Id.* at 175.

277. *See supra* note 14.

278. *Revlon*, 506 A.2d at 176.

279. *Id.* at 182.

280. *See Cox, supra* note 38, at 23.40.

281. *Id.*

282. 15 Pa. Cons. Stat. Ann. § 1715(a) (West 1995); *see also* Klein & Greenbaum, *supra* note 120.

283. *See* Block & Hoff, *supra* note 190, at 1.

284. 15 Pa. Cons. Stat. Ann. § 1715(d) (West 1995).

285. 571 A.2d 1140 (Del. 1989).

286. *Id.* After Time and Warner Communications had finalized Time's acquisition of Warner, Paramount Communications made a tender offer for Time, which Time's board rejected in the belief that the merger with Warner was in the shareholder's best long-term interests. *Id.* at 1143-49. The court held that the *Revlon* test was inapplicable because the transaction furthered a long-term interest of the corporation. *Id.* at 1151. The court decided that the fiduciary duty to manage a corporate enterprise includes the selection of the time frame for achievement of corporate goals. *Id.* at 1154-55.

holding in its judgment of the Conrail proceedings.<sup>287</sup> By permitting them to balance the interests of constituents other than shareholders, the Pennsylvania provision ultimately affords directors much greater freedom in making corporate decisions and alliances when confronted with a potential merger. As suggested by the advertisements<sup>288</sup> discussed in part II.B.2, this balancing act is difficult to judge and, coupled with the presumption in Pennsylvania that directors are acting in the best interests of the company,<sup>289</sup> will rarely be questioned.

On January 9, 1997, the federal district court denied Norfolk's later application for a preliminary injunction of the Conrail/CSX merger.<sup>290</sup> Norfolk had alleged that the CSX acquisition of 19.9% of Conrail's outstanding common stock should be aggregated with various directors' and officers' stock, which would form a controlling group pursuant to the fair price provisions and would entitle the shareholders to "fair value."<sup>291</sup>

The court identified two primary issues arising in the case: (1) whether the no-shop/lock-out provision in the Conrail/CSX merger agreement was enforceable; and (2) whether Conrail was obligated to pay the fair value amount because the control transaction had been triggered, as provided in the business corporation law.<sup>292</sup>

The court declined to change its earlier ruling that supported the no shop provision.<sup>293</sup> It reasoned that "it is expected that the parties will act in good faith and will not deliberately go out and . . . see if they can get a better deal after having entered into a valid contract."<sup>294</sup>

With respect to the argument that CSX actually represents a "controlling group," Judge Van Artsdalen was unpersuaded that there was an express agreement that Conrail directors and officers would vote their shares in "locked step" with CSX.<sup>295</sup> Furthermore, § 2541(b) contains an "inadvertent transactions" escape hatch for groups that accidentally acquire a controlling interest.<sup>296</sup> Therefore, the court denied Norfolk's motion for a preliminary injunction.<sup>297</sup> Subsequently, shareholders overwhelmingly voted against the Conrail proposal and,

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287. See Block & Hoff, *supra* note 190, at 1.

288. See *supra* notes 229 & 234-36.

289. See *supra* Part II.A.2.

290. Norfolk Southern Corp. v. Conrail Inc., C.A. No. 96-7167 and No. 7350, 1997 U.S. Dist. LEXIS 978 (E.D. Pa. Jan. 9, 1997).

291. *Id.* at \*2-\*3. This would, according to Norfolk, constitute a "group acting in concert" as defined under § 2543. *Id.* at \*8.

292. *Id.* at \*4.

293. *Id.* \*4-\*5.

294. *Id.* at \*5.

295. *Id.* at \*8.

296. 15 Pa. Cons. Stat. Ann. § 2541(b) (West 1995). This escape hatch allows groups, under certain circumstances, to avoid being considered a controlling group. *Id.*

297. Norfolk Southern, 1997 U.S. Dist. LEXIS 978.

in effect, sided with Norfolk.<sup>298</sup> Norfolk appealed both rulings to the Third Circuit and lost.<sup>299</sup>

#### D. *The Outcome of The Negotiations*

By December 19, 1996, CSX had already purchased 19.9% of Conrail stock,<sup>300</sup> which amounted to \$870 million. CSX offered to buy 18,344,845 more shares through a second cash tender at \$110 per share.<sup>301</sup> At that point, fewer than 100,000 shares had been tendered into the CSX offer.<sup>302</sup>

On January 14, 1997, Conrail printed a national advertisement supporting the CSX merger by pointing out the 640% lifetime return on Conrail stock.<sup>303</sup> The intended inference was that a Board that produces such high returns can be trusted to successfully navigate a merger.

CSX's offer was still approximately one billion dollars less than Norfolk's \$10.5 billion offer (\$115 per share).<sup>304</sup> Norfolk had spent \$75 million on the merger and Conrail took a \$16 million pretax charge for merger-related expenses in the fourth quarter of 1996.<sup>305</sup> Moody's, in light of the tremendous debt incurred to finance both tenders and the accompanying costs, downgraded the debt rating of both CSX and Norfolk.<sup>306</sup>

On February 14, 1997, the CSX tender offer to acquire 18,344,845 shares was extended to March 14.<sup>307</sup> Only 504,381 shares had been

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298. See *supra* notes 200-04 and accompanying text.

299. *Norfolk Southern Corp. v. Ferrara*, 111 F.3d 127 (3d Cir. 1997) (decision published & without opinion). This appellate ruling was issued after Norfolk and CSX agreed to divvy up Conrail. See Andrews Securities & Commodities Litigation Reporter, April 9, 1997, at 12; see also Cassel, *supra* note 23, at C2.

300. *CSX and Conrail Increase Merger Consideration by \$16 Per Share*, PR NEWswire, Dec. 19, 1996, available in WESTLAW, PRNEWS Database.

301. *Id.*

302. *Id.*

303. Wall St. J. (advertisement), Jan. 14, 1997, at C9.

304. See Susan Warner & Andrew Cassel, *Conrail's Fate Will Be Put to the Test*, Philadelphia Inquirer, Jan. 12, 1997, at C1.

305. *Norfolk Southern Moves to Unseat Conrail Board as Negotiations Stall*, Wall St. J., Feb. 11, 1997, at B2.

306. *Id.* Rating agencies, such as Moody's and Standard and Poor's, evaluate the credit risk of a company issuing debt. See Tamar Frankel, 1 *Securitization: Structured Financing, Financial Assets Pools, and Asset-Backed Securities* 97 (1991). Consequently, the companies with higher credit ratings are considered "safer" and are, therefore, able to issue debt on more favorable terms. Each company would have to borrow heavily to finance the joint tender. See *Railroads Predict Rise in Earnings*, Traffic World, May 5, 1997, at 24. Indeed, on May 14, 1997, Norfolk issued \$4.3 billion of bonds and notes. See *Norfolk-Based Firm Issues \$4.3 Billion of Bonds and Notes*, Virginian-Pilot & Ledger Star, May 15, 1997, at D1. It was the biggest sale of investment-grade corporate debt to date. *Id.* CSX previously raised \$2.5 billion from a bond issue. *Id.*

307. *CSX Extends Tender Offer*, PR NEWswire, Feb. 14, 1997, available in WESTLAW, PRNEWS Database.

tendered thus far<sup>308</sup> and, by the end of February, it seemed clear that Conrail shareholders would not tender into a less lucrative offer. Snow subsequently sent LeVan a letter suggesting that Conrail would have to be sold, and Norfolk would have to be brought into the deal.<sup>309</sup> This was a significant change in strategy for the CSX board that marked the beginning of the end for LeVan's dream of taking over the merged Conrail-CSX railroad.<sup>310</sup>

On March 3, 1997, Conrail announced that it was once again renegotiating its merger agreement with CSX.<sup>311</sup> Conrail said the new agreement would offer shareholders \$115 per share or \$10.5 billion total.<sup>312</sup> One analyst felt that Conrail shareholders emerged as winners from the compromise, in that they would now receive \$115 per share for stock worth barely \$70 at the beginning of the merger contest in October.<sup>313</sup> Such an outcome "[said] a lot for the power of shareholders."<sup>314</sup>

On April 8, 1997, CSX and Norfolk announced an agreement to divide Conrail's routes and assets.<sup>315</sup> To accomplish the division, they planned to form a jointly owned entity that will acquire all outstanding shares of Conrail for \$115 in cash per share.<sup>316</sup> By May 1997, CSX and Norfolk owned their respective shares of Conrail.<sup>317</sup> They cannot take over Conrail, however, until federal rail regulators approve the break-up plan.<sup>318</sup> It is still unclear how the transaction will affect Pennsylvania or the long-term financial prospects of Norfolk or CSX. Although both companies are optimistic<sup>319</sup> about their own financial conditions, many fear that job losses in Pennsylvania and other areas will be significant.<sup>320</sup>

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308. *Id.*

309. See Daniel Machalaba & Anna W. Mathews, *Meeting in the Betrayal Suite*, Wall St. J. Eur., Mar. 5, 1997, at 1.

310. *Id.*

311. See Charles Slack, *CSX, Conrail Revisit Merger Norfolk Southern May Back Deal*, Richmond Times-Dispatch, Mar. 4, 1997, at A1.

312. See Machalaba & Mathews, *supra* note 309, at 1.

313. See Slack, *supra* note 311, at A1.

314. *Id.* at A1 (quoting Peter Gleason, a Maryland based financial consultant).

315. Special Edition Conrail Newswire, *CXS, NS Announce Agreement on Dividing Conrail* (April 9, 1997), <<http://conrail.com/news/nw970409.htm>> Norfolk will buy 58% of Conrail for \$5.9 billion, and CSX will acquire 42% for \$4.3 billion. *Id.*; *Railroads Predict Rise in Earnings*, Traffic World, May 5, 1997, at 24.

316. See Special Edition Conrail Newswire, *supra* note 315.

317. See *Norfolk Southern, CSX Now Own Conrail*, Virginian-Pilot & Ledger Star, May 28, 1997, at D1.

318. *Id.*

319. See *Railroads Predict Rise in Earnings*, *supra* note 315, at 24.

320. See John George, *No Surprise: Conrail Breakup Brings Job Cuts*, Phila. Bus. J., June 27, 1997, at 3.

PART III  
CRITIQUE OF THE PENNSYLVANIA LEGISLATURE

In the battle for Conrail, both CSX and Norfolk claimed that the weight of state law supported their position. Norfolk was correct in claiming that the fair price provision protected shareholders from a potentially coercive two-tier CSX bid. CSX was correct in claiming that the other constituencies provision protected management from being forced to succumb to a higher-valued tender offer that could, potentially, negatively impact the Pennsylvania economy. The Pennsylvania legislature passed the anti-takeover provisions to protect against a single hostile bidder. Yet, when confronted with multiple bidders, the provisions created a stalemate. Conrail was ultimately acquired, in part, by a hostile bidder, Norfolk, and Conrail's shareholders were left with an extremely high tender price. This example of the application of the Pennsylvania anti-takeover statute suggests two important conclusions. First, highly complex and technical anti-takeover legislation is counter-productive. And, second, hastily passed anti-takeover legislation is ineffective because it fails to account for corporate complexity.

*A. The Conrail Saga Should Remind State Legislatures that  
Complex Anti-Takeover Statutes Are Counter-Productive*

Corporate law continues to evolve in response to the ever-changing structures of corporations.<sup>321</sup> Despite the central role corporations play in the American and global economy, states have been reluctant to pass legislation that may be so narrowly tailored that it fails to address the full scope of corporate possibilities. For example, although the backbone of corporate law hinges on the concept of fiduciary duty and the importance of defining a director's role on a corporate board,<sup>322</sup> this singularly important legal relationship is ambiguously defined and constantly reinvented with every legal controversy.<sup>323</sup> A highly technical and specific law defining when directors breach their fiduciary duty would create more problems than solutions.<sup>324</sup> Instead, courts are left to address each situation on an ad hoc basis.

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321. Note the recent developments of limited liability companies and limited liability partnerships, for example. See Glenn B. Davis & Barbara L. Bryaniarski, *Choice of Entity: Legal Considerations of Selection*, 50 Corp. Prac. Series 3d. (BNA) (1997) (discussing the basic forms of corporations).

322. See Solomon, *supra* note 30, at 591.

323. *Id.* Justice Frankfurter recognized the inherent complexities regarding fiduciary duty:

[T]o say that a man is a fiduciary only begins analysis; it gives direction to further inquiry. To whom is he a fiduciary? What obligations does he owe as a fiduciary? In what respect has he failed to discharge these obligations?

And what are the consequences of his deviation from duty?

SEC v. Chenery Corp., 318 U.S. 80, 85-86 (1943).

324. See Solomon, *supra* note 30, at 662-63, 667.



Similarly, state anti-takeover provisions that attempt to do too much, like Pennsylvania's aggressive legislation, often fail to achieve their stated goals. The Pennsylvania legislature attempted to insulate local companies from foreign predators. By passing so many different provisions, each with a different impact on tender offer and merger negotiations, the State ultimately created a statute that, in some instances, contradicts itself.

Beyond the statute's impact on the merger, a close examination of the law reveals other more general problems. It is difficult to imagine how the other constituencies provision could be enforced. First, when there is a breach of fiduciary duty, the appropriate party to bring a lawsuit would be a shareholder, through derivative action on behalf of the corporation.<sup>325</sup> If the breach is a result of the board ignoring other constituencies in an effort to secure the highest bid for shareholders, however, there is no incentive for a shareholder to bring suit. Further, if a shareholder does bring suit—perhaps a hostile shareholder with a duplicitous motive<sup>326</sup>—damages would be impossible to determine because the harm would be to the community at large and the long term interests of the corporation. This creates a conundrum for the Pennsylvania statute. Certainly it is possible for directors to violate their fiduciary duties in Pennsylvania.<sup>327</sup> The other constituencies statute, however, places the bar extremely high by justifying consideration of non-shareholder interests. Directors can pursue nearly any corporate strategy and claim they are fulfilling their fiduciary duty to some non-shareholder constituent.

Second, it is exceedingly difficult to judge whether any given bidder is actually better suited to protect other constituencies. Both CSX and Norfolk claimed to better serve stakeholders as well as protect long-term shareholder interests. It is difficult to imagine how a court would objectively determine whether a board was justified in favoring one bidder over another based on consideration of other constituencies.

Underlying this problem is a philosophical identity crisis in corporate America. To date, the majority of state corporate law is dedicated to the proposition that directors, as fiduciaries of the corporation, are responsible for maximizing shareholder value.<sup>328</sup> Although opponents of other constituencies provisions defend this as a singular interest,<sup>329</sup> it has been noted that different shareholders

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325. See Solomon, *supra* note 30, at 52.

326. Often, derivative lawsuits are brought by plaintiffs with very small equity holdings at the behest of attorneys. See Klein & Coffee, *supra* note 14, at 196.

327. See Block & Hoff, *supra* note 190, at 1 (discussing the impact of the other constituency provision).

328. See *supra* note 131.

329. Wallman, *supra* note 131, at 187-92.

with different investment schemes do not necessarily agree on a definition of maximized value.<sup>330</sup>

Ironically, it is arguable that Conrail ignored the non-shareholder constituencies by ultimately agreeing to a deal that includes breaking up the company between CSX and Norfolk. However, Senator Brightbill's fear that everyone in Pennsylvania would file a lawsuit alleging a violation of the other constituencies provision has not yet occurred.<sup>331</sup> It is extremely doubtful that the shareholders will sue the board for breach of fiduciary duty because, despite rhetoric to the contrary, Conrail accommodated their interests first by ultimately acceding to the highest bid price set by Norfolk.

In this case, the provisions forced an expensive showdown between CSX and Norfolk that left both companies in financial difficulty and significant debt.<sup>332</sup> Without the Pennsylvania statute, it is possible that CSX and Norfolk would have come to a resolution much sooner, before the bid escalated to such a high level. The other constituencies provision gave CSX the false hope that its inferior bid might actually succeed. This false hope cost all three companies dearly.

The fair price provision did succeed in protecting shareholders from being coerced into a lesser-valued bid. Moreover, the various provisions slowed down the process, allowing shareholders to exercise their rights and ensure the highest possible value for their shares. This was not, however, the overall intent of the Pennsylvania law.<sup>333</sup>

#### B. *Hastily Passed Anti-Takeover Legislation Fails to Account for Corporate Complexity*

Many states, like Pennsylvania, passed anti-takeover laws in a matter of days,<sup>334</sup> often in response to the imminent threat of a local hos-

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330. *Id.* at 187.

331. *See supra* note 156 and accompanying text.

332. *See supra* note 306 and accompanying text.

333. *See supra* notes 152-75.

334. Although the adoption process of the 1990 amendments to Pennsylvania's anti-takeover law spanned several months (they were introduced on October 20, 1989 and were signed into law, in a modified version, on April 27, 1990), this was a relatively short process. *See* McGurn & Spatola, *supra* note 42, at Pennsylvania-5-6. Other states moved with more zeal. *See supra* note 145 and accompanying text; *see also* McGurn & Spatola, *supra* note 42, at 2 (discussing the haste with which other states passed anti-takeover legislation).

When rumors circulated about a takeover of Boeing Corporation, for example, the Washington legislature met in emergency session and approved a bill, signed immediately by the governor, that had been drafted by Boeing counsel. Arizona state officials, at the request of Greyhound Corporation, introduced, adopted, and signed into law the Arizona Control Share Act in three days. It took Illinois only two days and Minnesota only one to pass their [anti-takeover] statutes.

Dale A. Oesterle, *The Law of Mergers, Acquisitions, and Reorganizations* 415 (West 1991).

tile acquisition.<sup>335</sup> It is, therefore, not surprising that these hastily-crafted statutes are less than perfect. The emergency measures are arguably the result of quick compromise and overly ambitious legislators eager to be seen as zealous defenders of the community interests.<sup>336</sup> The enactment of the Pennsylvania statute typifies such a roughshod legislative process.

Pennsylvania legislators tailored the many provisions of the anti-takeover legislation to deal specifically with the threatened Armstrong takeover.<sup>337</sup> The provisions, however, are not as neatly applied to other potential takeover situations, such as Conrail, where there are two out-of-state bidders that threaten layoffs and plant closings. Regardless, companies are able to pass anti-takeover provisions themselves.<sup>338</sup> What the Pennsylvania General Assembly gave by way of protecting shareholders' rights with the fair price provision, it seemed to take away by protecting management with the other constituencies provision. If state legislatures continue to insist on increasingly aggressive and more complicated anti-takeover provisions, they should conduct extensive analysis of a variety of scenarios to ensure the laws will effectively apply to a wide range of potential situations. They should begin by considering four important factors: (1) state corporate philosophy; (2) the anticipated number of bidders; (3) the anticipated type of bids offered; and (4) what type of bidder the state wants to encourage.

First, the state legislature must assess the state's corporate philosophy to decide whether a corporation should be primarily beholden to shareholders, or to the community at large. The Pennsylvania legislature was forced to reevaluate the function and role of the corporation

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335. See McGurn & Spatola, *supra* note 42. Companies facing imminent threats from hostile bidders included Burlington Industries in North Carolina, Gillette in Massachusetts, Greyhound in Arizona, Harcourt Brace Jovanovich in Florida, and G. Heileman Brewing in Wisconsin. McGurn & Spatola, *supra* note 42, at 2. In fact, the governor of Massachusetts signed the Massachusetts statute in the offices of Gillette. See Oesterle, *supra* note 334, at 415-16.

336. The obvious alternative would be a more deliberative process including extensive hearings and/or the establishment of legislative commissions to study the issue. See McGurn & Spatola, *supra* note 42, at 2.

337. See Tascarella, *supra* note 111, at 22.

338. The defensive measures provided by the Pennsylvania statute could have been accomplished by individual corporations without legislative action. John C. Coffee, Jr., *The Bylaw Battlefield: Can Institutions Change the Outcome of Corporate Control Contests?*, 51 U. Miami L. Rev. 605, 605-06 (1997). Amendments to corporate articles of incorporation, subject to requisite shareholder approval, could be passed with much the same effect. *Id.* Shareholders would, however, probably be reluctant to pass such corporate legislation knowing that hostile offers tend to increase share price, while anti-takeover provisions tend to decrease share price. For a discussion of the share price effect of the Pennsylvania anti-takeover legislation, see Chandy, *supra* note 28; see also McGurn & Spatola, *supra* note 42, at 3. For a detailed description of studies illustrating this relationship, see *id.* at Pennsylvania-7 to -11.

in American society.<sup>339</sup> The tenuous relationship between shareholders and directors and the amorphous concept of fiduciary duty made the debate contentious.<sup>340</sup> Although corporations were traditionally meant to serve the shareholder's profit interest,<sup>341</sup> society is increasingly demanding that state law recast corporate charters to implicitly include community-wide goals.<sup>342</sup> Any state legislature attempting to pass anti-takeover legislation or amend existing laws must confront a similar paradox. In constructing effective anti-takeover statutes, state legislatures must determine whether they will embrace the emerging trend and protect other constituencies, or whether they are more comfortable endorsing the traditional notion of fiduciary duties as owed to shareholders. The debate on the floor of the Pennsylvania legislature tracked this philosophical conflict.<sup>343</sup> Unfortunately, in haste, the legislation that passed was an irreconcilable combination of the two philosophies. Some portions of the anti-takeover provisions—for example, the fair price provision—was intended to protect shareholders and insure that they would be able to maximize their share value.<sup>344</sup> Other portions, however—for example, the other constituencies provision—was intended to protect management's ability to subvert shareholder profit for community goals.<sup>345</sup> In certain cases, like the Belzberg acquisition that prompted the debate in Pennsylvania,<sup>346</sup> the provisions work well together as the legislation intended. Belzberg was a single bidder.<sup>347</sup> The fair price provision prevented a coercive two-tier offer and the other constituencies statute ensured that boards had the authority to resist the threat. For scenarios like Belzberg, the legislation was effective but, in other cases, like the Conrail merger with CSX, the provisions worked against one another. The process of creating anti-takeover legislation must begin with a thorough assessment of corporate philosophy and how it applies to a wide variety of situations.

Second, the state legislature should consider the possibility of multiple bidders. Provisions that apply to a single hostile bidder may simply not work with two or even three bidders. In October, 1997, MCI Communications Corporation went "in play" as British Telecommunications PLC, GTE Corporation, and WorldCom Incorporated all be-

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339. See *supra* notes 150-75 and accompanying text for a discussion of the debate regarding corporate philosophy.

340. See *supra* notes 131-44 and accompanying text.

341. See *supra* note 135 and accompanying text.

342. See Wallman, *supra* note 131, at 167-68.

343. See *supra* notes 152-75 and accompanying text.

344. See discussion *supra* Part I.B.3.

345. See discussion *supra* Part I.B.5.

346. See discussion *supra* note 145.

347. See McGurn & Spatola, *supra* note 43, at Pennsylvania-5.

gan to compete for corporate control.<sup>348</sup> Although the battle will not take place in Philadelphia, the specter of three potential bidders should give the Pennsylvania legislature cause for concern—their legislation isn't tailored to deal with such a situation. If a similar situation arose in Pennsylvania, it is difficult to predict the result. The two bidder Conrail situation was already beyond the contemplated scope of the state's anti-takeover situation. Increasingly exotic situations would only seem to move farther from the intended effect of the provisions. The possibility that multiple bidders may compete for control of a local company must be considered when envisioning how the various provisions will interact.

Third, the state legislature should consider the types of bids that may be offered in a takeover situation. Although CSX was considered a "friendly" bidder, its two-tier bid set CSX at odds with Pennsylvania's fair price provision. The Conrail merger showed that, in a two-bidder situation where the friendly bidder was making a two-tier front-loaded inferior offer, the fair price provision rendered the other constituencies provision meaningless.<sup>349</sup> Even if the other constituencies provision was relevant to the final outcome of the negotiations, it would be impossible to accurately assess which suitor would be best for Conrail.<sup>350</sup> The other constituencies provision inevitably leads to the subordination of shareholder interests and confuses the role of directors as fiduciaries.<sup>351</sup> So long as shareholders will not be coerced into tendering into a two-tier front-loaded offer, they will rarely be persuaded to sacrifice their own interests for other constituencies when confronted with a higher valued bid. Regardless of the community-wide benefits of a merger, Pennsylvania law still leaves the final decision in the hands of the shareholders, if there is a two-tier offer, because the fair price provision effectively trumps the other constituencies provision. Legislatures must consider the innovative ways in which a company may attempt to coerce shareholders into tendering their shares.

Fourth, the state legislature should determine exactly what it considers a "friendly," as opposed to "hostile," bidder. In the case of Conrail, it was difficult to tell who was the friendly bidder. Although

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348. Stephanie N. Mehta, *Bargain or Burden? The Question of MCI's Worth*, Wall St. J., Oct. 20, 1997, at B10; Steven Lipin, *Battle for MCI May Be Just Beginning*, Wall St. J., Oct. 17, 1997, at A3.

349. See discussion *supra* Part II.B.1.

350. Scholars have attempted to solve this conundrum by articulating standards of review for corporate boards. Wallman, *supra* note 131, at 172-73.

351. For a thorough discussion of the complexity inherent in this type of provision, see Wallman, *supra* note 131. Wallman is an advocate of this type of provision and, in fact, co-drafted the first corporate constituency statute enacted in 1983, as well as the Pennsylvania corporate law amendments reaffirming the corporate constituency concept. *Id.* at 163, n.\*\*. Although Wallman supports other constituency provisions, he acknowledges that shareholder interests are subordinated from their previous status and that there is some confusion regarding the director's duty. *Id.* at 10.

Conrail management sided with CSX, shareholders clearly preferred Norfolk's bid. With respect to the Pennsylvania economy, it was impossible to determine which suitor would have more positively impacted the community. Yet because of Pennsylvania's complex legislation, both companies claimed the moral high ground.

### CONCLUSION

The Pennsylvania provisions inadvertently succeeded in slowing down the merger process and bringing all relevant parties together. They also provided Conrail shareholders with a final share price far beyond expectation. On the other hand, Conrail was ultimately acquired, at least in part, by a foreign hostile bidder and, subsequent to the acquisition, will be broken up by CSX and Norfolk. This was what the anti-takeover legislation was intended to prevent.

The Conrail saga suggests important lessons for state legislatures under political pressure to pass comprehensive anti-takeover provisions on a moment's notice. The ever-evolving face of corporate America is not effectively governed by highly technical and complex laws. Like the simple definition of fiduciary duty that leaves interpretation to the courts, anti-takeover legislation must be simple enough to understand and flexible enough to consistently apply to the myriad of possible takeover situations. For this reason, state anti-takeover provisions should be viewed with skepticism and the trend towards increasing their scope and comprehensiveness should be reconsidered. As Conrail illustrated, Pennsylvania's legislation was so aggressive that, in this instance, the other constituencies provision was without force. Ultimately, complicated anti-takeover provisions are self-defeating because they cannot contemplate every conceivable corporate variation.

If state legislatures continue to support anti-takeover legislation, they should avoid hastily-passed statutes intended to prevent a specific acquisition. Such short-sighted political aggression will have costly effects when new unanticipated situations arise. If Pennsylvania's legislature had met weeks before CSX and Conrail publicly announced their merger plans, it is probable they could have amended the provisions to protect the merger from Norfolk's subsequent unfriendly bid. The provisions created in the midst of the hostile Belzberg takeover, however, were ill-suited to this new circumstance. Had the state assembly done their homework when confronting the Belzberg situation, Pennsylvania could have realized its goal of protecting the state economy from debilitating split-ups.